ROYAL BANK OF CANADA
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Royal Bank of Canada
$3,350,000
Market Linked Securities—Leveraged Upside Participation to a Cap and Fixed Percentage Buffered Downside Principal at Risk Securities Linked to the EURO STOXX 50® Index, due September 6, 2022

The securities described in this pricing supplement are issued by Royal Bank of Canada (Royal Bank of Canada or the Issuer), and are Senior Global Medium-Term Notes, Series G of the Issuer, as described in the prospectus supplement and prospectus each dated January 8, 2016.

Agent:	Wells Fargo Securities, LLC. The agent may make sales through its affiliates or selling agents.
Principal Amount:	Each security will have a principal amount of $1,000. The securities are not principal-protected. You may lose up to 80% of the principal amount of the securities.
Pricing Date:	August 31, 2017
Original Issue Date:	September 6, 2017
Valuation Date:	August 29, 2022, subject to postponement as described below.
Maturity Date:	September 6, 2022, subject to postponement as described below.
Interest:	We will not pay you interest during the term of the securities.
Index:	The return on the securities is linked to the performance of the EURO STOXX 50® Index (Bloomberg symbol: SX5E), which we refer to as the Index.
Payment at Maturity:	The amount you receive at maturity, for each security you own, will depend upon the change in the level of the Index based on the Final Index Level relative to the Initial Index Level, and whether or not the Final Index Level is below the Buffer Level. (i) If the Final Index Level is greater than the Initial Index Level, the maturity payment amount per security will equal the lesser of: (a) $\$1{,}000 + \left(\$1{,}000 \times \frac{\text{Final Index Level} - \text{Initial Index Level}}{\text{Initial Index Level}} \times \text{Participation Rate}\right)$; and (b) the maximum maturity payment amount (ii) If the Final Index Level is equal to or less than the Initial Index Level but greater than or equal to the Buffer Level, the maturity payment amount per security will equal $1,000. (iii) If the Final Index Level is less than the Buffer Level, the maturity payment amount per security will equal: $\$1{,}000 - \left(\$1{,}000 \times \frac{\text{Buffer Level} - \text{Final Index Level}}{\text{Initial Index Level}}\right)$ In such a case, you will lose up to 80% of your principal.
Maximum Maturity Payment Amount:	$1,910.00 per security
Participation Rate:	200%
Initial Index Level:	3,421.47, which was the closing level of the Index on the pricing date.
Final Index Level:	The closing level of the Index on the valuation date.
Buffer Level:	2,737.176, which is 80% of the Initial Index Level.
Listing:	The securities will not be listed on any securities exchange.

CUSIP Number: 78012K4G9

Our initial estimated value of the securities as of the date of this document is $936.81 per $1,000 in principal amount, which is less than the public offering price. The market value of the securities at any time will reflect many factors, cannot be predicted with accuracy, and may be less than this amount. See "Risk Factors" and "Supplemental Plan of Distribution – Structuring the Securities" for further information.

The securities will be unsecured debt obligations of Royal Bank of Canada. Payments on the securities are subject to Royal Bank of Canada's credit risk. If Royal Bank of Canada defaults on its obligations, you could lose your entire investment. No other company or entity will be responsible for payments under the securities or liable to holders of the securities in the event Royal Bank of Canada defaults under the securities. The securities will not be issued by or guaranteed by Wells Fargo Securities, LLC or any of its affiliates.

The securities will not constitute deposits insured by the Canada Deposit Insurance Corporation, the U.S. Federal Deposit Insurance Corporation (the "FDIC") or any other Canadian or U.S. government agency or instrumentality.

For a detailed description of the terms of the securities, see "Summary Information" beginning on page PS-2 and "Specific Terms of the Securities" beginning on page PS-16. Defined terms used in this cover page are defined in "Summary Information" and "Specific Terms of the Securities."

The securities have complex features and investing in the securities involves risks. See "Risk Factors" beginning on page PS-10 of this document and page S-1 of the accompanying prospectus supplement.

	Per Security	Total
Public Offering Price	$1,000.00	$3,350,000.00
Underwriting Discount and Commission [(1)]	$44.90	$150,415.00
Proceeds to Royal Bank of Canada	$955.10	$3,199,585.00

[(1)] The agent will receive an underwriting discount and commission of $44.90 per security. Of that underwriting discount and commission, each dealer that sells securities will receive a selling concession of $25.00 for each security that such dealer sells. Such securities dealers may include Wells Fargo Advisors ("WFA") (the trade name of the retail brokerage business of Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC). In addition to the selling concession allowed to WFA, the agent will pay $1.20 per security of the underwriting discount and commission to WFA as a distribution expense fee for each security sold by WFA. See "Use of Proceeds and Hedging" and "Supplemental Plan of Distribution" in this pricing supplement for information regarding how we may hedge our obligations under the securities.

None of the Securities and Exchange Commission, any state securities commission or any other regulatory body has approved or disapproved of the securities or passed upon the adequacy or accuracy of this pricing supplement. Any representation to the contrary is a criminal offense.

Wells Fargo Securities

The date of this pricing supplement is August 31, 2017

SUMMARY INFORMATION

This document is a pricing supplement. This pricing supplement provides specific pricing information in connection with this issuance of securities. This summary includes questions and answers that highlight selected information from this pricing supplement and the accompanying prospectus supplement and prospectus to help you understand the Market Linked Securities Leveraged Upside Participation to a Cap and Fixed Percentage Buffered Downside Principal at Risk Securities Linked to the EURO STOXX 50® Index, due September 6, 2022 (the securities). You should carefully read this pricing supplement and the accompanying prospectus supplement and prospectus to fully understand the terms of the securities and the tax and other considerations relating to the securities. You should carefully review the section "Risk Factors" in this pricing supplement and the accompanying prospectus supplement and prospectus, which highlight certain risks associated with an investment in the securities, to determine whether an investment in the securities is appropriate for you.

Unless otherwise mentioned or unless the context requires otherwise, all references in this pricing supplement to "Royal Bank of Canada", "we", "us" and "our" or similar references mean Royal Bank of Canada. Capitalized terms used in this pricing supplement without definition have the meanings given to them in the accompanying prospectus supplement and prospectus.

What are the securities?

The securities offered by this pricing supplement will be issued by Royal Bank of Canada and will mature on September 6, 2022. The return on the securities, if any, will be linked to the performance of the EURO STOXX 50® Index, which we refer to as the Index. The securities will not bear interest and no other payments will be made until maturity. You may lose up to 80% of your investment in the securities.

As discussed in the accompanying prospectus supplement, the securities are debt securities and are part of a series of debt securities entitled "Senior Global Medium-Term Notes, Series G" that Royal Bank of Canada may issue from time to time. The securities will rank equally with all other unsecured and unsubordinated debt of Royal Bank of Canada. For more details, see "Specific Terms of the Securities" beginning on page PS-16.

Each security will have a principal amount of $1,000. Each security will be offered at an initial public offering price of $1,000. However, on the pricing date, our initial estimated value of the securities is less than $1,000 per security as a result of certain costs that are included in the initial public offering price. See "Risk Factors—Our initial estimated value of the securities is less than the initial public offering price" and "Supplemental Plan of Distribution—Structuring the Securities." To the extent a market for the securities exists, you may transfer only whole securities. Royal Bank of Canada will issue the securities in the form of a master global certificate, which is held by The Depository Trust Company, also known as DTC, or its nominee. Direct and indirect participants in DTC will record your ownership of the securities.

Are the securities principal protected?

No, the securities do not guarantee any return of principal at maturity. If the Final Index Level is less than the Buffer Level, you will be exposed on a 1-to-1 basis to declines in the level of the Index beyond the Buffer Level. Accordingly, if the Final Index Level is below the Buffer Level, you will lose up to 80% of your principal.

What will I receive upon maturity of the securities?

At maturity, for each security you own, you will receive a cash payment equal to the maturity payment amount. The maturity payment amount to which you will be entitled depends on the percentage change in the level of the Index calculated based on the Final Index Level (as defined below) relative to the Initial Index Level (as defined below), and whether or not the Final Index Level is below the Buffer Level (as defined below).

The maturity payment amount for each security will be determined by the calculation agent as described below:

- If the Final Index Level is greater than the Initial Index Level, the maturity payment amount per security will equal the lesser of:

$$\text{(a) } \$1{,}000 + \left(\$1{,}000 \times \frac{\text{Final Index Level} - \text{Initial Index Level}}{\text{Initial Index Level}} \times \text{Participation Rate}\right)\text{; and}$$

(b) the maximum maturity payment amount

The Participation Rate is 200%. The maximum maturity payment amount is $1,910.00 per security.

- If the Final Index Level is equal to or less than the Initial Index Level, but greater than or equal to the Buffer Level, the maturity payment amount per security will equal $1,000.
- If the Final Index Level is less than the Buffer Level, the maturity payment amount per security will equal:

$$\$1{,}000 - \left(\$1{,}000 \times \frac{\text{Buffer Level} - \text{Final Index Level}}{\text{Initial Index Level}}\right)$$

If the Final Index Level is less than the Buffer Level, the amount you will receive at maturity will be less than the principal amount of the securities, and you will lose up to 80% of your principal. If the Final Index Level is zero, the maturity payment amount will be $200.00 per security, and you will lose 80% of your principal.

The Initial Index Level is equal to 3,421.47, which was the closing level of the Index on the pricing date.

The Buffer Level is 2,737.176, which is 80% of the Initial Index Level.

The Final Index Level will be determined by the calculation agent and will be the closing level of the Index on the valuation date.

The valuation date is August 29, 2022. However, if that day occurs on a day that is not a trading day (as defined on page PS-20) or on a day on which the calculation agent has determined that a market disruption event (as defined under "Specific Terms of the Securities—Market Disruption Event" below) has occurred or is continuing, then the valuation date will be postponed until the next succeeding trading day on which the calculation agent determines that a market disruption event does not occur or is not continuing; provided that in no event will the valuation date be postponed by more than five trading days. If the valuation date is postponed, then the maturity date of the securities will be postponed by an equal number of business days. The maturity date will be a business day. In the event the maturity date would otherwise be a date that is not a business day, the maturity date will be postponed to the next succeeding date that is a business day and no interest shall accrue or be payable as a result of the postponement.

The closing level on any trading day will equal the official closing level of the Index or any successor Index (as defined under "Specific Terms of the Securities—Discontinuation of the Index; Adjustments to the Index" below) published by the Index Sponsor (as defined below) or any successor index sponsor at the regular weekday close of trading on that trading day. In certain circumstances, the closing level will be based on the alternate calculation of the Index described under "Specific Terms of the Securities—Discontinuation of the Index; Adjustments to the Index" below.

You should understand that the opportunity to benefit from the possible increase in the level of the Index through an investment in the securities is limited because the amount that you receive at maturity will never exceed the maximum maturity payment amount. The maximum maturity payment amount represents a maximum appreciation on the securities of 91.00% over the principal amount of the securities. If the Final Index Level is less than the Buffer Level, you will you will be exposed on a 1-to-1 basis to declines in the level of the Index beyond the Buffer Level. Accordingly, if the level of the Index decreases below the Buffer Level, you will lose up to 80% of your principal.

Hypothetical Examples

Set forth below are four hypothetical examples of the calculation of the maturity payment amount based on hypothetical Final Levels and the following terms of the securities (the numbers appearing in the examples below have been rounded for ease of analysis):

Initial Index Level: 3,421.47

Buffer Level: 2,737.176

Maximum maturity payment amount: $1,910.00

Example 1—The hypothetical Final Index Level is 60.00% of the Initial Index Level, which is below the Buffer Level:

Hypothetical Final Index Level: 2,052.88

$$\text{Maturity payment amount (per security)} = \$1{,}000 - \left(\$1{,}000 \times \frac{2{,}737.176 - 2{,}052.88}{3{,}421.47}\right) = \$800.00$$

Since the hypothetical Final Index Level is less than the Initial Index Level and below the Buffer Level, the amount you will receive at maturity will be equal to the issue price of $1,000 per security minus $1,000 times the difference between the Buffer Level and the hypothetical Final Index Level, divided by the Initial Index Level, and you would lose some of your principal. Although the hypothetical Final Index level declined by 40.00% from the Initial Index Level to the hypothetical Final Index Level, your total cash payment at maturity would be $800.00 per security, representing a 20.00% loss of the principal amount of your securities.

Example 2—The hypothetical Final Index Level is 95.00% of the Initial Index Level, which is below the Initial Index Level, but above the Buffer Level:

Since the hypothetical Final Index Level is less than the Initial Index Level but greater than the Buffer Level, the maturity payment amount per security will equal the principal amount of $1,000.

Example 3—The hypothetical Final Index Level is 110.00% of the Initial Index Level:

Hypothetical Final Index Level: 3,763.62

$$\text{Maturity payment amount (per security)} = \$1{,}000 + \left(\$1{,}000 \times \frac{3{,}763.62 - 3{,}421.47}{3{,}421.47} \times 200\%\right)$$

$$= \$1{,}000 + \$200.00 = \$1{,}200.00$$

Since the hypothetical Final Index Level is greater than the Initial Index Level, you would receive the principal amount of $1,000 plus 200% times the amount of the percentage change in the level of the Index times $1,000, subject to the maximum maturity payment amount of $1,910.00. As the calculation of the maturity payment amount without taking into account the maximum maturity payment amount would generate a result of $1,200.00 per security, your maturity payment amount would not be subject to the maximum maturity payment amount of $1,910.00 per security. Your total cash payment at maturity would be $1,200.00 per security, representing a 20.00% total return.

Example 4—The hypothetical Final Index Level is 150.00% of the Initial Index Level:
Hypothetical Final Index Level: 5,132.21

$$\text{Maturity payment amount (per security)} = \$1{,}000 + \left(\$1{,}000 \times \frac{5{,}132.21 - 3{,}421.47}{3{,}421.47} \times 200\%\right)$$

$$= \$1{,}000 + \$1{,}000.00 = \$2{,}000.00 > \$1{,}910.00$$

Since the hypothetical Final Index Level is greater than the Initial Index Level, you would receive the principal amount of $1,000 plus 200% times the amount of the percentage change in the level of the Index times $1,000, subject to the maximum maturity payment amount of $1,910.00. Although the calculation of the maturity payment amount without taking into account the maximum maturity payment amount would generate a result of $2,000.00 per security, your maturity payment amount would be limited to $1,910.00 per security, representing a 91.00% total return, because the payment on the securities at maturity may not exceed the maximum maturity payment amount.

Hypothetical Returns

The following table is based on the maturity payment amount of $1,910.00, the Initial Index Level of 3,421.47 and a range of hypothetical Final Index Levels and illustrates:

- the percentage change from the Initial Index Level to the hypothetical Final Index Level;
- the hypothetical maturity payment amount per security; and
- the hypothetical pre-tax total rate of return to beneficial owners of the securities.

The figures below are rounded for ease of analysis and are for purposes of illustration only. The actual maturity payment amount will depend on the actual Final Index Level as determined by the calculation agent as described in this pricing supplement.

Hypothetical Final Index Level	Percentage Change from the Initial Index Level to the Hypothetical Final Index Level	Hypothetical Maturity Payment Amount per Security	Hypothetical Pre-Tax Total Rate of Return on the Securities
1,368.59	-60.00%	$600.00	-40.00%
1,710.74	-50.00%	$700.00	-30.00%
1,881.81	-45.00%	$750.00	-25.00%
2,052.88	-40.00%	$800.00	-20.00%
2,223.96	-35.00%	$850.00	-15.00%
2,395.03	-30.00%	$900.00	-10.00%
2,566.10	-25.00%	$950.00	-5.00%
2,737.176 (1)	-20.00%	$1,000.00	0.00%
3,079.32	-10.00%	$1,000.00	0.00%
3,164.86	-7.50%	$1,000.00	0.00%
3,250.40	-5.00%	$1,000.00	0.00%
3,335.93	-2.50%	$1,000.00	0.00%
3,421.47 (2)	0.00%	$1,000.00	0.00%
3,507.01	2.50%	$1,050.00	5.00%
3,592.54	5.00%	$1,100.00	10.00%
3,678.08	7.50%	$1,150.00	15.00%
3,763.62	10.00%	$1,200.00	20.00%
4,105.76	20.00%	$1,400.00	40.00%
4,447.91	30.00%	$1,600.00	60.00%
4,618.98	35.00%	$1,700.00	70.00%
4,790.06	40.00%	$1,800.00	80.00%
4,978.24	45.50%	$1,910.00 (3)	91.00%
5,132.21	50.00%	$1,910.00	91.00%
5,474.35	60.00%	$1,910.00	91.00%

(1) This is the Buffer Level.
(2) This is the Initial Index Level.
(3) This is the maximum maturity payment amount of $1,910.00.

The following graph sets forth the return at maturity for a range of hypothetical percentage changes of the Index, based on a maximum maturity payment amount of $1,910.00 per $1,000 security (91.00% over the principal amount).
Return Profile of Market Linked Securities —Leveraged Upside Participation to a Cap
and Fixed Percentage Buffered Downside Principal at Risk Securities vs. the Index

Who should or should not consider an investment in the securities?
We have designed the securities for investors who seek exposure to the Index, who believe that the Index level will increase over the term of the securities, and who want to participate in 2.00 times the possible appreciation of the Index (measured by the percentage change in the level of the Index based on the Final Index Level relative to the Initial Index Level), subject to the maximum maturity payment amount of 91.00% over the principal amount of the securities; who understand that, if the Final Index Level is less than the Buffer Level, they will lose money on their investment; and who are willing to hold their securities until maturity. Investors in the securities should be willing to risk up to 80% of their investment.
The securities are not designed for, and may not be a suitable investment for, investors who are unable or unwilling to hold the securities to maturity, who seek principal protection for their investment, who are unwilling to make an investment exposed to downside performance risk of the Index or who are unwilling to purchase securities with an initial estimated value as of the pricing date that is lower than the initial public offering price. The securities may not be a suitable investment for investors who prefer the lower risk of fixed income investments with comparable maturities issued by companies with comparable credit ratings.

What will I receive if I sell the securities prior to maturity?

The market value of the securities may fluctuate during the term of the securities. Several factors and their interrelationship will influence the market value of the securities, including the level of the Index, dividend yields of the common stocks underlying the Index, the time remaining to maturity of the securities, interest rates and the volatility of the Index. Depending on the impact of these factors, you may receive less than $1,000 per security from any sale of your securities before the maturity date of the securities and less than what you would have received had you held the securities until maturity. Assuming no change in market conditions or other relevant factors, the price, if any, at which you may be able to sell your securities prior to maturity will be less than the initial public offering price and, subject to the discussion regarding secondary market prices during the three months following the original issue date in "Supplemental Plan of Distribution" on page PS-31, will be less than the initial estimated value of the securities set forth on the cover page. For more details, see "Risk Factors — Many factors affect the market value of the securities" on page PS-11 and "—The price, if any, at which you may be able to sell your securities prior to maturity may be less than the initial public offering price and our initial estimated value" on page PS-13.

Who publishes the Index and what does the Index measure?

The EURO STOXX 50® Index (the Index) is an equity index that is composed of 50 component stocks of sector leaders in 11 Eurozone countries and is intended to provide an indication of common stock price movement in the Eurozone. The Index is published by STOXX Limited (the Index Sponsor).

The Index is determined, calculated and maintained by the Index Sponsor without regard to the securities.

You should be aware that an investment in the securities does not entitle you to any ownership interest in the common stocks of the companies included in the Index. For a discussion of the Index, see "EURO STOXX 50® Index" below.

How has the Index performed historically?

You can find a table with the high, low and period-end closing levels of the Index during each calendar quarter from the first quarter of 2007 to the present, in the section entitled "EURO STOXX 50® Index— Historical Closing Levels of the Index" in this pricing supplement. We obtained the historical information from Bloomberg Financial Markets without independent verification. You should not take the past performance of the Index as an indication of how the Index will perform in the future.

What are the United States federal income tax consequences of investing in the securities?

The terms of the securities require a holder and us (in the absence of a change in law or an administrative or judicial ruling to the contrary) to treat the securities for all tax purposes as pre-paid cash-settled derivative contracts in respect of the Index. If the securities are so treated, a U.S. holder should generally recognize capital gain or loss upon the sale, exchange or maturity of the securities in an amount equal to the difference between the amount a holder receives at such time and the holder's tax basis in the securities.

Please read carefully the section entitled "Supplemental Discussion of U.S. Federal Income Tax Consequences" in this pricing supplement, the section entitled "Tax Consequences" in the accompanying prospectus and the section entitled "Certain Income Tax Consequences" in the accompanying prospectus supplement. You should consult your tax advisor about your own tax situation.

What are the Canadian federal income tax consequences of investing in the securities?

For a discussion of the Canadian federal income tax consequences of investing in the securities, please read carefully the section entitled "Tax Consequences" in the accompanying prospectus and the section entitled "Certain Income Tax Consequences" in the accompanying prospectus supplement. You should consult your tax advisor about your own tax situation.

Will the securities be listed on a stock exchange?

The securities will not be listed on any securities exchange. There can be no assurance that a liquid trading market will develop for the securities. Accordingly, if you sell your securities prior to maturity, you may have to sell them at a substantial loss. You should review the section entitled "Risk Factors—There may not be an active trading market for the securities" in this pricing supplement.

Are there any risks associated with my investment?

Yes, an investment in the securities is subject to significant risks, including the risk of loss of up to 80% of your principal. We urge you to read the detailed explanation of risks in "Risk Factors" beginning on page PS-10 of this document and page S-1 of the accompanying prospectus supplement.

ADDITIONAL INFORMATION

You should read this pricing supplement together with the prospectus dated January 8, 2016, as supplemented by the prospectus supplement dated January 8, 2016, relating to our Senior Global Medium-Term Notes, Series G, of which these securities are a part. This pricing supplement, together with these documents, contains the terms of the securities and supersedes all other prior or contemporaneous oral statements as well as any other written materials including preliminary or indicative pricing terms, correspondence, trade ideas, structures for implementation, sample structures, brochures or other educational materials of ours.

You should rely only on the information provided or incorporated by reference in this pricing supplement, the prospectus and the prospectus supplement. We have not authorized anyone else to provide you with different information, and we take no responsibility for any other information that others may give you. We and Wells Fargo Securities, LLC are offering to sell the securities and seeking offers to buy the securities only in jurisdictions where it is lawful to do so. The information contained in this pricing supplement and the accompanying prospectus supplement and prospectus is current only as of their respective dates.

If the information in this pricing supplement differs from the information contained in the prospectus supplement or the prospectus, you should rely on the information in this pricing supplement.

You should carefully consider, among other things, the matters set forth in “Risk Factors” in this pricing supplement and the accompanying prospectus supplement, as the securities involve risks not associated with conventional debt securities. We urge you to consult your investment, legal, tax, accounting and other advisers before you invest in the securities.

You may access these documents on the SEC website at www.sec.gov as follows (or if such address has changed, by reviewing our filings for the relevant date on the SEC website):

- Prospectus dated January 8, 2016:
http://www.sec.gov/Archives/edgar/data/1000275/000121465916008810/j18160424b3.htm

- Prospectus Supplement dated January 8, 2016:
http://www.sec.gov/Archives/edgar/data/1000275/000121465916008811/p14150424b3.htm

Our Central Index Key, or CIK, on the SEC website is 1000275.

Please see the section “Documents Incorporated by Reference” on page i of the above prospectus for a description of our filings with the SEC that are incorporated by reference therein.

RISK FACTORS

An investment in the securities is subject to the risks described below, as well as the risks described under "Risk Factors" in the accompanying prospectus supplement and prospectus. The securities have complex features and are a riskier investment than ordinary debt securities. Also, your securities are not equivalent to investing directly in the Index or the common stocks included in the Index. Investors in the securities are also exposed to further risks related to the Issuer of the securities, Royal Bank of Canada, which are described in Royal Bank of Canada's most recent annual report on Form 40-F filed with the SEC and incorporated by reference herein. See the categories of risks identified and disclosed in the management's discussion and analysis of financial condition and results of operations included in the annual report on Form 40-F. This section (and the management's discussion and analysis section of the annual report on Form 40-F) describes the most significant risks relating to the securities. You should carefully consider whether the securities are suited to your particular circumstances.

Your investment may result in a loss of up to 80% of your principal

We will not repay you a fixed amount of principal on the securities at maturity. The payment at maturity on the securities will depend on the percentage change in the level of the Index based on the Final Index Level relative to the Initial Index Level, and whether or not the Final Index Level is below the Buffer Level. Because the level of the Index is subject to market fluctuations, the amount of cash you receive at maturity may be more or less than the principal amount of the securities. If the Final Index Level is less than the Buffer Level, you will be exposed on a 1-to-1 basis to declines in the level of the Index beyond the Buffer Level. Accordingly, if the level of the Index decreases below the Buffer Level, you will lose up to 80% of your principal.

You will not receive interest payments on the securities

You will not receive any periodic interest payments on the securities or any interest payment at maturity. Your payment at maturity will depend on the percentage change in the level of the Index based on the Final Index Level relative to the Initial Index Level, and whether or not the Final Index Level falls below the Buffer Level.

Your yield may be lower than the yield on a standard debt security of comparable maturity

The yield that you will receive on your securities, which could be negative, may be less than the return you could earn on other investments. Even if your yield is positive, your yield may be less than the yield you would earn if you bought a standard senior non-callable debt security of Royal Bank of Canada with the same maturity date. Your investment may not reflect the full opportunity cost to you when you take into account factors that affect the time value of money. Unlike conventional senior non-callable debt securities, the securities do not guarantee the return of all of the principal amount at maturity. In addition, no interest will be paid during the term of your securities.

Your return is limited and will not reflect the return of owning the common stocks underlying the Index

You should understand that the opportunity to participate in the possible appreciation in the level of the Index through an investment in the securities is limited because the amount that you receive at maturity will never exceed the maximum maturity payment amount. The maximum maturity payment amount represents a maximum appreciation on the securities of 91.00% over the principal amount of the securities. Although any positive return on the securities is based on 2.00 times any percentage increase of the Index, in no event will the amount you receive at maturity be greater than the maximum maturity payment amount of $1,910.00 per security.

Owning the securities is not the same as owning the common stocks underlying the Index

The return on your securities will not reflect the return you would realize if you actually owned and held the common stocks underlying the Index for a similar period. First, because the maturity payment amount will be determined based on the performance of the Index, which is a price-return index, the return on the securities will not take into account the value of any dividends that may be paid on the common stocks underlying the Index. Second, as a holder of the securities, you will not be entitled to receive any dividend payments or other distributions on the common stocks underlying the Index, nor will you have voting rights or any other rights that holders of those common stocks may have. Even if the level of the Index increases above the Initial Index Level during the term of the securities, the market value of the securities may not increase by the same amount. It is also possible for the level of the Index to increase while the market value of the securities declines.

There may not be an active trading market for the securities

The securities will not be listed on any securities exchange. There can be no assurance that a liquid trading market will develop for the securities. Even if a secondary market for the securities develops, it may not provide significant liquidity and transaction costs in any secondary market could be high. As a result, the difference between bid and asked prices for the securities in any secondary market could be substantial. If you sell your securities before maturity, you may have to do so at a discount from the initial public offering price, and, as a result, you may suffer substantial losses.

Wells Fargo Securities, LLC and its broker-dealer affiliates may make a market for the securities, although they are not required to do so. As market makers, trading of the securities may cause Wells Fargo Securities, LLC or its broker-dealer affiliates to have long or short positions in the securities. Because we do not expect that any other market makers will participate in a secondary market for the securities, the price at which you may be able to sell your securities is likely to depend on the price, if any, at which Wells Fargo Securities, LLC or its broker-dealer affiliates may be willing to buy your securities. See "Supplemental Plan of Distribution."

The amount to be paid at maturity is not linked to the level of the Index at any time other than the valuation date

The payment at maturity will be based on the level of the Index only on the valuation date. Therefore, for example, if the closing level of the Index decreased precipitously on the valuation date, the payment on the securities may be significantly less than it would otherwise have been had the payment been linked to the closing level of the Index prior to that decrease. Although the actual level of the Index on the maturity date or at other times during the term of the securities may be higher than the Index level on the valuation date, you will not benefit from the closing level of the Index at any time other than the valuation date.

Many factors affect the market value of the securities

The market value of the securities will be affected by factors that interrelate in complex ways. It is important for you to understand that the effect of one factor may offset any increase in the market value of the securities caused by another factor and that the effect of one factor may compound any decrease in the market value of the securities caused by another factor. For example, a change in the volatility of the Index may offset some or all of any increase in the market value of the securities attributable to another factor, such as an increase in the level of the Index. In addition, a change in interest rates may offset other factors that would otherwise change the level of the Index, and therefore, may change the market value of the securities. We expect that the market value of the securities will depend to a significant extent on the amount, if any, by which the Index level during the term of the securities exceeds or does not exceed the Initial Index Level. If you choose to sell your securities when the level of the Index exceeds the Initial Index Level, you may receive substantially less than the amount that would be payable at maturity based on this level because of the expectation that the Index will continue to fluctuate until the valuation date. We believe that other factors that may also influence the value of the securities include:

- the volatility (frequency and magnitude of changes in the level) of the Index and, in particular, market expectations regarding the volatility of the Index;
- market interest rates in the U.S.;
- the dividend yields of the common stocks included in the Index;
- our creditworthiness, as perceived in the market;
- changes that affect the Index, such as additions, deletions or substitutions;
- the time remaining to maturity; and
- geopolitical, economic, financial, political, regulatory or judicial events as well as other conditions may affect the common stocks included in the Index.

The securities will be debt obligations of Royal Bank of Canada. No other company or entity will be responsible for payments under the securities

The securities will be issued by Royal Bank of Canada. The securities will not be guaranteed by any other company or entity. No other entity or company will be responsible for payments under the securities or liable to holders of the securities in the event Royal Bank of Canada defaults under the securities. Royal Bank of Canada's credit ratings are an assessment of our ability to pay our obligations, including those on the securities. Consequently, if we default on our obligations, you could lose your entire investment, and actual or anticipated declines in our creditworthiness may affect the value of the securities. The securities will not be issued by or guaranteed by Wells Fargo Securities, LLC or any of its affiliates.

Changes that affect the Index will affect the market value of the securities and the maturity payment amount

The policies of the Index Sponsor concerning the calculation of the Index, additions, deletions or substitutions of the common stocks underlying the Index and the manner in which changes affecting the issuers of those stocks, such as stock dividends, reorganizations or mergers, are reflected in the Index could affect the level of the Index, the maturity payment amount, and the market value of the securities prior to maturity. The amount payable on the securities and their market value could also be affected if the Index Sponsor changes these policies, for example, by changing the manner in which it calculates the Index, or if the Index Sponsor discontinues or suspends calculation or publication of the Index, in which case it may become difficult to determine the market value of the securities. If events such as these occur, or if the level of the Index is not available on the valuation date because of a market disruption event or for any other reason and no successor index is selected, the calculation agent may determine the level of the Index — and thus the maturity payment amount — in its sole discretion.

We have no affiliation with the Index Sponsor and will not be responsible for any actions taken by the Index Sponsor

We have no affiliation with the Index Sponsor and the Index Sponsor will not be involved in the offering of the securities. Consequently, we have no control of the actions of the Index Sponsor, including any actions of the type that would affect the composition of the Index, and therefore, the level of the Index. The Index Sponsor has no obligation of any sort with respect to the securities. Thus, the Index Sponsor has no obligation to take your interests into consideration for any reason, including in taking any actions that might affect the value of the securities.

Historical levels of the Index should not be taken as an indication of the future levels of the Index during the term of the securities

The trading prices of the common stocks underlying the Index will determine the Index level at any given time. As a result, it is impossible to predict whether the level of the Index will rise or fall. Trading prices of the common stocks underlying the Index will be influenced by complex and interrelated political, economic, financial and other factors that can affect the issuers of those stocks.

Hedging transactions may affect the return on the securities

As described below under "Use of Proceeds and Hedging" on page PS-30, we, through one or more hedging counterparties, may hedge our obligations under the securities by purchasing common stocks underlying the Index, futures or options on the Index or common stocks underlying the Index, or exchange-traded funds or other derivative instruments with returns linked or related to changes in the level of the Index or trading prices of common stocks underlying the Index, and may adjust these hedges by, among other things, purchasing or selling any of these assets at any time. Although they are not expected to, any of these hedging activities may adversely affect the trading prices of common stocks underlying the Index and/or the level of the Index and, therefore, the market value of the securities. It is possible that we or one or more of our hedging counterparties could receive substantial returns from these hedging activities while the market value of the securities declines.

Our initial estimated value of the securities is less than the initial public offering price

Our initial estimated value of the securities is less than the initial public offering price of the securities. This is due to, among other things, the fact that the initial public offering price of the securities reflects the borrowing rate we pay to issue securities of this kind (an internal funding rate that is lower than the rate at which we borrow funds by issuing conventional fixed rate debt), and the inclusion in the initial public offering price of the underwriting discount and commission and hedging and other costs associated with the securities.

The price, if any, at which you may be able to sell your securities prior to maturity may be less than the initial public offering price and our initial estimated value

Assuming no change in market conditions or any other relevant factors, the price, if any, at which you may be able to sell your securities prior to maturity will be less than the initial public offering price and, subject to the discussion in the next paragraph, will be less than our initial estimated value. This is because any such sale price would not be expected to include the underwriting discount and commission or hedging or other costs associated with the securities, including the estimated profit our hedging counterparty(ies) expect to realize in consideration for assuming the risks inherent in hedging our obligations under the securities. In addition, any price at which you may sell the securities is likely to reflect customary bid-ask spreads for similar trades, and the cost of unwinding any related hedge transactions. In addition, the value of the securities determined for any secondary market price is expected to be based in part on the yield that is reflected in the interest rate on our conventional debt securities of similar maturity that are traded in the secondary market, rather than the internal funding rate that we used to price the securities and determine the initial estimated value. As a result, the secondary market price of the securities will be less than if the internal funding rate was used. These factors, together with various credit, market and economic factors over the term of the securities, and, potentially, changes in the level of the Index, are expected to reduce the price at which you may be able to sell the securities in any secondary market and will affect the value of the securities in complex and unpredictable ways. Moreover, we expect that any secondary market price will be based on Wells Fargo Securities, LLC's valuation of the securities, which may differ from (and may be lower than) the valuation that we would determine for the securities at that time based on the methodology by which we determined the initial estimated value set forth on the cover page of this document.

As set forth below in the section "Supplemental Plan of Distribution," for a limited period of time after the original issue date, Wells Fargo Securities, LLC may purchase the securities at a price that is greater than the price that would otherwise be determined at that time as described in the preceding paragraph. However, over the course of that period, assuming no changes in any other relevant factors, the price you may receive if you sell your securities is expected to decline.

The securities are not designed to be short-term trading instruments. Accordingly, you should be able and willing to hold your securities to maturity.

The initial estimated value of the securities is an estimate only, calculated as of the time the terms of the securities were set

Our initial estimated value of the securities is based on the value of our obligation to make the payments on the securities, together with the mid-market value of the derivative embedded in the terms of the securities. See "Supplemental Plan of Distribution—Structuring the Securities" below. Our estimate is based on a variety of assumptions, including our internal funding rate (which represents a discount from our credit spreads), expectations as to dividends on the securities included in the Index, interest rates and volatility, and the expected term of the securities. These assumptions are based on certain forecasts about future events, which may prove to be incorrect. Other entities, including Wells Fargo Securities, LLC in connection with determining any secondary market price for the securities, may value the securities or similar securities at a price that is significantly different than we do.

The value of the securities at any time after the pricing date will vary based on many factors, including changes in market conditions, and cannot be predicted with accuracy. As a result, the actual value you would receive if you sold the securities in any secondary market, if any, should be expected to differ materially from our initial estimated value of your securities.

Potential conflicts of interest could arise

We, Wells Fargo Securities, LLC and our respective affiliates may engage in trading activities related to the Index or the common stocks underlying the Index that are not for the account of holders of the securities or on their behalf. These trading activities may present a conflict between the holders' interest in the securities and the interests we, Wells Fargo Securities, LLC and our respective affiliates will have in the proprietary accounts, in facilitating transactions, including options and other derivatives transactions, for our customers and in accounts under our management. These trading activities could be adverse to the interests of the holders of the securities.

We, Wells Fargo Securities, LLC and our respective affiliates may presently or from time to time engage in business with one or more of the issuers of the common stocks underlying the Index. This business may include extending loans to, or making equity investments in, such companies or providing advisory services to such companies, including merger and acquisition advisory services. In the course of business, we, Wells Fargo Securities, LLC and our respective affiliates may acquire non-public information relating to these companies and, in addition, one or more of our affiliates or the affiliates of the agent may publish research reports about these companies. Neither we nor the agent make any representation to any purchasers of the securities regarding any matters whatsoever relating to the issuers of the common stocks underlying the Index. Any prospective purchaser of the securities should undertake an independent investigation of these companies as in its judgment is appropriate to make an informed decision regarding an investment in the securities. The offering of the securities does not reflect any investment or sell recommendations as to the Index or the securities underlying the Index by us, Wells Fargo Securities, LLC or our respective affiliates.

The calculation agent may postpone the valuation date and, therefore, determination of the Final Index Level and the maturity date if a market disruption event occurs on the valuation date

The valuation date and, therefore, determination of the Final Index Level may be postponed if the calculation agent determines that a market disruption event has occurred or is continuing on the valuation date with respect to the Index. If a postponement occurs, the calculation agent will use the closing level of the Index on the next succeeding trading day on which no market disruption event occurs or is continuing as the Final Index Level. As a result, the maturity date for the securities would be postponed. You will not be entitled to compensation from us or the calculation agent for any loss suffered as a result of the occurrence of a market disruption event, any resulting delay in payment or any change in the level of the Index after the valuation date. See "Specific Terms of the Securities—Valuation Date" and "—Market Disruption Events" below.

There are potential conflicts of interest between you and the calculation agent

The calculation agent will, among other things, determine the amount of your payment at maturity on the securities. Our wholly-owned subsidiary, RBC Capital Markets, LLC, will serve as the calculation agent. We may change the calculation agent after the original issue date without notice to you. The calculation agent will exercise its judgment when performing its functions. For example, the calculation agent may have to determine whether a market disruption event affects the Index. Since this determination by the calculation agent will affect the payment at maturity on the securities, the calculation agent may have a conflict of interest if it needs to make a determination of this kind. In addition, the calculation agent determined the initial estimated value of the securities set forth on the cover page of this pricing supplement.

Risks associated with non-U.S. companies.

The level of the Index depends upon the stocks of companies located within the Eurozone, and thus involve risks associated with the home countries of those non-U.S. companies, some of which are and have been experiencing economic stress. The prices of these non-U.S. stocks may be affected by political, economic, financial and social factors in the home country of each applicable company, including changes in that country's government, economic and fiscal policies, currency exchange laws or other laws or restrictions, which could affect the value of the securities. These foreign securities may have less liquidity and could be more volatile than many of the securities traded in U.S. or other securities markets. Direct or indirect government intervention to stabilize the relevant foreign securities markets, as well as cross shareholdings in foreign companies, may affect trading levels or prices and volumes in those markets. The other special risks associated with foreign securities may include, but are not limited to: less liquidity and smaller market capitalizations; less rigorous regulation of securities markets; different accounting and disclosure standards; governmental interference; currency fluctuations; higher inflation; and social, economic and political uncertainties. These factors may adversely affect the performance of the Index and, as a result, the value of the securities.

The securities will not be adjusted for changes in exchange rates.

Although the equity securities that comprise the Index are traded in euro, and your securities are denominated in U.S. dollars, the amount payable on your securities at maturity, if any, will not be adjusted for changes in the exchange rates between the U.S. dollar and the euro. Changes in exchange rates, however, may also reflect changes in the applicable non-U.S. economies that in turn may affect the level of the Index, and therefore your securities. The amount we pay in respect of your securities will be determined solely in accordance with the procedures described in this pricing supplement.

PS-15

Significant aspects of the tax treatment of the securities are uncertain

The tax treatment of the securities is uncertain. We do not plan to request a ruling from the Internal Revenue Service or from the Canada Revenue Agency regarding the tax treatment of the securities, and the Internal Revenue Service, the Canada Revenue Agency or a court may not agree with the tax treatment described in this pricing supplement.

The Internal Revenue Service has issued a notice indicating that it and the U.S. Treasury Department are actively considering whether, among other issues, a holder should be required to accrue interest over the term of an instrument such as the securities even though that holder will not receive any payments with respect to the securities until maturity or earlier sale or exchange and whether all or part of the gain a holder may recognize upon sale, exchange or maturity of an instrument such as the securities should be treated as ordinary income. The outcome of this process is uncertain and could apply on a retroactive basis.

Please read carefully the section entitled “Supplemental Discussion of U.S. Federal Income Tax Consequences” in this pricing supplement, the section entitled “Tax Consequences” in the accompanying prospectus and the section entitled “Certain Income Tax Consequences” in the accompanying prospectus supplement. You should consult your tax advisor about your own tax situation.

For a discussion of the Canadian federal income tax consequences of investing in the securities, please read the section entitled “Tax Consequences” in the accompanying prospectus and the section entitled “Certain Income Tax Consequences” in the accompanying prospectus supplement. You should consult your tax advisor about your own tax situation.

SPECIFIC TERMS OF THE SECURITIES

The securities are to be issued pursuant to the terms of the Indenture dated as of October 23, 2003, between Royal Bank of Canada and The Bank of New York Mellon (as successor to JPMorgan Chase Bank, N.A.), as Trustee, as supplemented by the First Supplemental Indenture dated as of July 21, 2006, between Royal Bank of Canada and The Bank of New York (as successor to JPMorgan Chase Bank, N.A.), as Trustee and by the Second Supplemental Indenture dated as of February 28, 2007 between Royal Bank of Canada and The Bank of New York Mellon (as successor to JPMorgan Chase Bank, N.A.), as Trustee (the Base Indenture, together with the First Supplemental Indenture and the Second Supplemental Indenture, the "Indenture").

The information contained in this section and in the prospectus supplement and the prospectus summarizes some of the terms of the securities and the Indenture. This summary does not contain all of the information that may be important to you as a potential investor in the securities. You should read the Indenture before making your investment decision. We have filed copies of the Indenture with the SEC.

Issuer:	Royal Bank of Canada
Specified Currency:	U.S. dollars
Principal Amount:	$1,000 per security
Aggregate Principal Amount:	$3,350,000
Agent:	Wells Fargo Securities, LLC The agent may make sales through its affiliates or selling agents.
Agent Acting in the Capacity of:	Principal
Pricing Date:	August 31, 2017
Original Issue Date:	September 6, 2017
Maturity Date:	September 6, 2022, subject to postponement as described below. The maturity date will be a business day. In the event the maturity date would otherwise be a date that is not a business day, the maturity date will be postponed to the next succeeding date that is a business day and no interest shall accrue or be payable as a result of that postponement.
Valuation Date:	August 29, 2022. However, if that day occurs on a day that is not a trading day or on a day on which the calculation agent has determined that a market disruption event (as defined under "—Market Disruption Events" below) has occurred or is continuing, then the valuation date will be postponed until the next succeeding trading day on which the calculation agent determines that a market disruption event does not occur or is not continuing; provided that in no event will the valuation date be postponed by more than five trading days. If the valuation date is postponed by five trading days, and a market disruption event occurs or is continuing on that fifth trading day, then the Final Index Level will nevertheless be determined as set forth on the next page under "—Closing Level of the Index". If the valuation date is postponed, then the maturity date of the securities will be postponed by an equal number of business days.
The Index:	The return on the securities is linked to the performance of the EURO STOXX 50® Index (the Index).
Payment at Maturity:	At maturity, for each security you own, you will receive a cash payment equal to the maturity payment amount. The maturity payment amount to which you will be entitled depends on the change in the level of the Index based on the Final Index Level relative to the Initial Index Level, and whether or not the Final Index Level is below the Buffer Level. The maturity payment amount for each security will be determined by the calculation agent as described below:

PS-17

	· If the Final Index Level is greater than the Initial Index Level, the maturity payment amount per security will equal the lesser of: (a) $\$1{,}000 + \left(\$1{,}000 \times \frac{\text{Final Index Level} - \text{Initial Index Level}}{\text{Initial Index Level}} \times \text{Participation Rate}\right)$; and (b) the maximum maturity payment amount · If the Final Index Level is less than or equal to the Initial Index Level but greater than or equal to the Buffer Level, the maturity payment amount per security will equal $1,000. · If the Final Index Level is less than the Buffer Level, the maturity payment amount per security will equal: $\$1{,}000 - \left(\$1{,}000 \times \frac{\text{Buffer Level} - \text{Final Index Level}}{\text{Initial Index Level}}\right)$ In such a case, you will lose up to 80% of your principal. If the Final Index Level is less than the Buffer Level, you will lose up to 80% of your principal. If the Final Index Level is zero, the maturity payment amount will be $200.00 per security. If any payment is due on the securities on a day which is not a business day, then that payment may be made on the next day that is a business day, in the same amount and with the same effect as if paid on the original due date. No interest shall be payable as a result of such postponement.
Maximum Maturity Payment Amount:	$1,910.00 per security
Initial Index Level:	3,421.47, which was the closing level of the Index on the pricing date.
Final Index Level:	The closing level of the Index on the valuation date, as determined by the calculation agent.
Buffer Level:	2,737.176, which is 80% of the Initial Index Level.
Closing Level of the Index:	The official closing level of the Index or any successor index (as defined under "—Discontinuation of the Index; Adjustments to the Index" below) published by the Index Sponsor or any successor index sponsor at the regular weekday close of trading on that trading day. In certain circumstances, the closing level will be based on the alternate calculation of the Index described under "—Discontinuation of the Index; Adjustments to the Index" below.
Participation Rate:	200%
Market Disruption Events:	As determined by the calculation agent in its sole discretion, a "market disruption event" means any of (A), (B), (C) or (D) below: A. Any of the following events occurs or exists with respect to any security included in the Index or any successor index, and the aggregate of all securities included in the Index or such successor index with respect to which any such event occurs comprise 20% or more of the level of the Index or such successor index: · a material suspension of or limitation imposed on trading by the relevant stock exchange for such security or otherwise at any time during the one-hour period that ends at the scheduled closing time for the relevant stock exchange for such security on that day, whether by reason of movements in price exceeding limits permitted by the relevant stock exchange or otherwise;

· any event, other than an early closure, that materially disrupts or impairs the ability of market participants in general to effect transactions in, or obtain market values for, such security on its relevant stock exchange at any time during the one-hour period that ends at the scheduled closing time for the relevant stock exchange for such security on that day; or

· the closure on any exchange business day of the relevant stock exchange for such security prior to its scheduled closing time unless the earlier closing is announced by such relevant stock exchange at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such relevant stock exchange and (ii) the submission deadline for orders to be entered into the relevant stock exchange system for execution at the scheduled closing time for such relevant stock exchange on that day.

B. Any of the following events occurs or exists with respect to futures or options contracts relating to the equity index or any successor index:

· a material suspension of or limitation imposed on trading by any related futures or options exchange or otherwise at any time during the one-hour period that ends at the close of trading on such related futures or options exchange on that day, whether by reason of movements in price exceeding limits permitted by the related futures or options exchange or otherwise;

· Any event, other than an early closure, that materially disrupts or impairs the ability of market participants in general to effect transactions in, or obtain market values for, futures or options contracts relating to the Index or such successor index on any related futures or options exchange at any time during the one-hour period that ends at the close of trading on such related futures or options exchange on that day; or

· the closure on any exchange business day of any related futures or options exchange prior to its scheduled closing time unless the earlier closing time is announced by such related futures or options exchange at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such related futures or options exchange and (ii) the submission deadline for orders to be entered into the related futures or options exchange system for execution at the close of trading for such related futures or options exchange on that day.

C. The Index Sponsor fails to publish the level of the Index or any successor index (other than as a result of the Index Sponsor having discontinued publication of the Index or successor index and no successor index being available).

D. Any related futures or options exchange fails to open for trading during its regular trading session.

For the purposes of determining whether a market disruption event has occurred:

· the relevant percentage contribution of a security included in the Index or any successor index to the level of such index will be based on a comparison of (x) the portion of the level of such index attributable to that security to (y) the overall level of such index, in each case using the official opening weightings as published by the relevant index sponsor as part of the market opening data;

· the “scheduled closing time” of any relevant stock exchange or related futures or options exchange on any trading day means the scheduled weekday closing

	time of such relevant stock exchange or related futures or options exchange on such trading day, without regard to after hours or any other trading outside the regular trading session hours; and an "exchange business day" means any trading day on which (i) the relevant index sponsor publishes the level of the Index or any successor equity index and (ii) each related futures or options exchange is open for trading during its regular trading session, notwithstanding any related futures or options exchange closing prior to its scheduled closing time.
Related Futures or Options Exchange:	An exchange or quotation system where trading has a material effect (as determined by the calculation agent) on the overall market for futures or options contracts relating to the Index.
Relevant Stock Exchange:	For any security underlying the Index, the primary exchange or quotation system on which such security is traded, as determined by the calculation agent.
Discontinuation of/Adjustments to the Index:	If the Index Sponsor discontinues publication of the Index and the Index Sponsor or another entity publishes a successor or substitute index that the calculation agent determines, in its sole discretion, to be comparable to the Index (a successor index), then the calculation agent will substitute the successor index as calculated by the Index Sponsor or any other entity for the Index and calculate the Final Index Level as described above under "—Closing Level of the Index." If the Index Sponsor discontinues publication of the Index and: · the calculation agent does not select a successor index, or · the successor index is no longer published on any of the relevant trading days, the calculation agent will compute a substitute level for the Index in accordance with the procedures last used to calculate the level of the Index before any discontinuation but using only those securities that were included in the Index prior to that discontinuation. If a successor index is selected or the calculation agent calculates a level as a substitute for the Index as described below, the successor index or level will be used as a substitute for the Index for all purposes going forward, including for purposes of determining whether a market disruption event exists, even if the Index Sponsor elects to begin republishing the Index, unless the calculation agent in its sole discretion decides to use the republished Index. If the Index Sponsor discontinues publication of the Index before the valuation date and the calculation agent determines that no successor index is available at that time, then on each trading day until the earlier to occur of: · the determination of the Final Index Level, or · a determination by the calculation agent that a successor index is available, the calculation agent will determine the level that would be used in computing the maturity payment amount as described in the preceding paragraph as if that day were a trading day. The calculation agent will cause notice of each level to be published not less often than once each month in The Wall Street Journal, another newspaper of general circulation or a website or webpage available to holders of the securities, and arrange for information with respect to these levels to be made available by telephone. Notwithstanding these alternative arrangements, discontinuation of the publication of the Index would be expected to adversely affect the value of, liquidity of and trading in the securities. If at any time the method of calculating the level of the Index or the successor index changes in any material respect, or if the Index or successor index is in any other way modified so that the level of the Index or successor index does not, in the opinion of the calculation agent, fairly represent the level of the Index had those changes or modifications not been made, then, from and after that time, the calculation agent will, at the close of business in The City of New York, on each date that the closing level of

	the Index is to be calculated, make any adjustments as, in the good faith judgment of the calculation agent, may be necessary in order to arrive at a calculation of a level of a stock index comparable to the Index or the successor index, as the case may be, as if those changes or modifications had not been made, and calculate the closing level with reference to the Index or the successor index, as so adjusted. Accordingly, if the method of calculating the Index or a successor index is modified and has a dilutive or concentrative effect on the level of that index e.g., due to a split, then the calculation agent will adjust that index in order to arrive at a level of that index as if it had not been modified, e.g., as if a split had not occurred. Neither the calculation agent nor Royal Bank of Canada will have any responsibility for good faith errors or omissions in calculating or disseminating information regarding the Index or any successor index or as to modifications, adjustments or calculations by the Index Sponsor or any successor index sponsor in order to arrive at the level of the Index or any successor index.
Calculation Agent:	RBC Capital Markets, LLC will serve as the calculation agent. All determinations made by the calculation agent will be at the sole discretion of the calculation agent and, absent a determination of a manifest error, will be conclusive for all purposes and binding on the holders and beneficial owners of the securities.
Trustee:	The Bank of New York Mellon
Business Day:	For purposes of the securities, a business day means a Monday, Tuesday, Wednesday, Thursday or Friday that is not a day on which banking institutions in The City of New York generally are authorized or obligated by law, regulation or executive order to close.
Trading Day:	A day, as determined by the calculation agent, on which (i) the Index Sponsor is scheduled to publish the level of the Index and (ii) each related futures or option exchange is scheduled to be open for trading for its regular trading session.
Additional Amounts:	We will pay any amounts to be paid by us on the securities without deduction or withholding for, or on account of, any and all present or future income, stamp and other taxes, levies, imposts, duties, charges, fees, deductions or withholdings (taxes) now or hereafter imposed, levied, collected, withheld or assessed by or on behalf of Canada or any Canadian political subdivision or authority that has the power to tax, unless the deduction or withholding is required by law or by the interpretation or administration thereof by the relevant governmental authority. At any time a Canadian taxing jurisdiction requires us to deduct or withhold for or on account of taxes from any payment made under or in respect of the securities, we will pay such additional amounts (Additional Amounts) as may be necessary so that the net amounts received by each holder (including Additional Amounts), after such deduction or withholding, shall not be less than the amount the holder would have received had no such deduction or withholding been required. However, no Additional Amounts will be payable with respect to a payment made to a holder of a security or of a right to receive payments in respect thereto (a Payment Recipient), which we refer to as an Excluded Holder, in respect of any taxes imposed because the beneficial owner or Payment Recipient: (i) is someone with whom we do not deal at arm’s length (within the meaning of the Income Tax Act (Canada)) at the time of making such payment; (ii) is subject to such taxes by reason of its being connected presently or formerly with Canada or any province or territory thereof otherwise than by reason of the holder’s activity in connection with purchasing the securities, the holding of securities or the receipt of payments thereunder; (iii) is, or does not deal at arm’s length with a person who is, a specified

shareholder (within the meaning of subsection 18(5) of the Income Tax Act (Canada)) of Royal Bank of Canada (generally a person will be a specified shareholder for this purpose if that person, either alone or together with persons with whom the person does not deal at arm's length, owns 25% or more of (a) our voting shares, or (b) the fair market value of all of our issued and outstanding shares);

(iv) presents such security for payment (where presentation is required) more than 30 days after the relevant date (except to the extent that the holder thereof would have been entitled to such Additional Amounts on presenting a security for payment on the last day of such 30 day period); for this purpose, the relevant date in relation to any payments on any security means:

a. the due date for payment thereof, or

b. if the full amount of the monies payable on such date has not been received by the Trustee on or prior to such due date, the date on which the full amount of such monies has been received and notice to that effect is given to holders of the securities in accordance with the Indenture;

(v) could lawfully avoid (but has not so avoided) such withholding or deduction by complying, or requiring that any agent comply with, any statutory requirements necessary to establish qualification for an exemption from withholding or by making, or requiring that any agent make, a declaration of non-residence or other similar claim for exemption to any relevant tax authority; or

(vi) is subject to deduction or withholding on account of any tax, assessment, or other governmental charge that is imposed or withheld by reason of the application of Section 1471 through 1474 of the United States Internal Revenue Code of 1986, as amended (Code) (or any successor provisions), any regulation, pronouncement, or agreement thereunder, official interpretations thereof, or any law implementing an intergovernmental approach thereto, whether currently in effect or as published and amended from time to time.

For the avoidance of doubt, we will not have any obligation to pay any holders Additional Amounts on any tax which is payable otherwise than by deduction or withholding from payments made under or in respect of the securities at maturity.

We will also make such withholding or deduction and remit the full amount deducted or withheld to the relevant authority in accordance with applicable law. We will furnish to the Trustee, within 30 days after the date the payment of any taxes is due pursuant to applicable law, certified copies of tax receipts evidencing that such payment has been made or other evidence of such payment satisfactory to the Trustee. We will indemnify and hold harmless each holder of the securities (other than an Excluded Holder) and upon written request reimburse each such holder for the amount of (x) any taxes so levied or imposed and paid by such holder as a result of payments made under or with respect to the securities, and (y) any taxes levied or imposed and paid by such holder with respect to any reimbursement under (x) above, but excluding any such taxes on such holder's net income or capital.

For additional information, see the section entitled "Tax Consequences—Canadian Taxation" in the accompanying prospectus.

Authorized Denominations:	$1,000 and integral multiples of $1,000 in excess thereof.
Form of Securities:	Book-entry

Listing:	The securities will not be listed on any securities exchange.
Failure to Pay Maturity Payment Amount When Due:	In the event we fail to pay the maturity payment amount on the maturity date, any overdue payment in respect of the maturity payment amount of the securities on the maturity date will bear interest until the date upon which all sums due in respect of such securities are received by or on behalf of the relevant holder, at a rate per annum which is the rate for deposits in U.S. dollars for a period of six months which appears on the Reuters Page LIBOR01 (or any replacement page or pages for the purpose of displaying prime rates or base lending rates of major U.S. banks) as of 11:00 a.m. (London time) on the first business day following that failure to pay. That rate will be determined by the calculation agent. If interest is required to be calculated for a period of less than one year, it will be calculated on the basis of a 360-day year consisting of the actual number of days in the period.
Events of Default and Acceleration:	If the maturity of the securities is accelerated upon an event of default under the Indenture, the amount payable upon acceleration will be determined by the calculation agent. The amount will be the maturity payment amount, calculated as if the date of declaration of acceleration were the valuation date.
Terms Incorporated in the Master Note:	All of the terms in “Specific Terms of the Securities.”

EURO STOXX 50® INDEX

All disclosures contained in this document regarding the Index, including, without limitation, its make-up, method of calculation, and changes in its components, have been derived from publicly available sources. The information reflects the policies of, and is subject to change by, STOXX Limited, as the sponsor of the Index ("STOXX"). STOXX, which owns the copyright and all other rights to the Index, has no obligation to continue to publish, and may discontinue publication of, the Index. None of us, Wells Fargo Securities, LLC or RBCCM accepts any responsibility for the calculation, maintenance or publication of the Index or any successor index.

The Index was created by STOXX and is currently wholly owned by Deutsche Börse AG. Publication of the Index began in February 1998, based on an initial index level of 1,000 at December 31, 1991. Changes to the component stocks are implemented on the third Friday in September and are effective the following trading day. Changes in the composition of the Index are made to ensure that the Index includes the 50 market sector leaders from within the EURO STOXX Total Market Index. Additional information about the Index is available on the STOXX Limited website: http://www.stoxx.com. However, information included in that website is not included or incorporated by reference in this document.

For each of the 19 EURO STOXX regional supersector indices, the stocks are ranked in terms of free-float market capitalization. The largest stocks are added to the selection list until the coverage is close to, but still less than, 60% of the free-float market capitalization of the corresponding supersector index. If the next highest-ranked stock brings the coverage closer to 60% in absolute terms, then it is also added to the selection list. All current stocks in the Index are then added to the selection list. All of the stocks on the selection list are then ranked in terms of free-float market capitalization to produce the final index selection list. The largest 40 stocks on the selection list are selected; the remaining 10 stocks are selected from the largest remaining current stocks ranked between 41 and 60; if the number of stocks selected is still below 50, then the largest remaining stocks are selected until there are 50 stocks. In exceptional cases, STOXX's management board can add stocks to and remove them from the selection list.

The index components are subject to a capped maximum index weight of 10%, which is applied on a quarterly basis. The Index is composed of 50 component stocks of market sector leaders from within the EURO STOXX® supersector indices, which includes stocks selected from the Eurozone portion of the STOXX Europe 600® supersector indices. The component stocks have a high degree of liquidity and represent the largest companies across a wide range of market sectors.

Computation of the Index

The Index is calculated with the "Laspeyres formula," which measures the aggregate price changes in the component stocks against a fixed base quantity weight. The formula for calculating the index level can be expressed as follows:

$$\text{Index} = \frac{\text{free float market capitalization of the index at the time}}{\text{divisor of the index at the time}}$$

The "free float market capitalization of the index" is equal to the sum of the products of the closing price, number of shares, free float factor, weighting cap factor, and the exchange rate from local currency into the index currency for the component company as of the time that the Index is being calculated.

The divisor of the Index is adjusted to maintain the continuity of the Index's values across changes due to corporate actions, such as cash dividends, rights offerings, stock dividends from treasury shares, repurchases of shares and self tender, and spin-offs.

Index Maintenance

The composition of the Index is reviewed annually, based on the closing stock data on the last trading day in August. Changes in the composition of the Index are made to ensure that the Index includes the 50 market sector leaders from within the Index. The component stocks are announced on the first trading day in September.

The free float factors for each component stock used to calculate the Index, as described below, are reviewed, calculated, and implemented on a quarterly basis and are fixed until the next quarterly review.

The Index is subject to a "fast exit rule." The index components are monitored for any changes based on the monthly selection list ranking. A stock is deleted from the Index if: (a) it ranks 75 or below on the monthly selection list and (b) it has been ranked 75 or below for a consecutive period of two months in the monthly selection list. The highest-ranked

stock that is not an index component will replace it. Changes will be implemented on the close of the fifth trading day of the month, and are effective the next trading day.

The Index is also subject to a "fast entry rule." All stocks on the latest selection lists and initial public offering (IPO) stocks are reviewed for a fast-track addition on a quarterly basis. A stock is added, if (a) it qualifies for the latest STOXX blue-chip selection list generated end of February, May, August or November and (b) it ranks within the "lower buffer" on this selection list.

The Index is also reviewed on an ongoing basis. Corporate actions (including initial public offerings, mergers and takeovers, spin-offs, delistings, and bankruptcy) that affect the index composition are immediately reviewed. Any changes are announced, implemented, and made effective in line with the type of corporate action and the magnitude of the effect.

License Agreement

Royal Bank of Canada has entered into a non-exclusive license agreement with STOXX, which grants us a license in exchange for a fee to use the Index in connection with the issuance of certain securities, including the securities. STOXX has no relationship to Royal Bank of Canada, other than the licensing of the Index and its service marks for use in connection with the securities.

STOXX does not:

§ sponsor, endorse, sell or promote the securities.

§ recommend that any person invest in the securities or any other financial products.

§ have any responsibility or liability for or make any decisions about the timing, amount or pricing of the securities.

§ have any responsibility or liability for the administration, management or marketing of the securities.

§ consider the needs of the securities or the owners of the securities in determining, composing or calculating the Index or have any obligation to do so.

STOXX will not have any liability in connection with the securities. Specifically, STOXX does not make any warranty, express or implied, and STOXX disclaims any warranty about:

- the results to be obtained by the securities, the owner of the securities or any other person in connection with the use of the Index and the data included in the Index;
- the accuracy or completeness of the Index or its data;
- the merchantability and the fitness for a particular purpose or use of the Index or its data;
- any errors, omissions or interruptions in the Index or its data; and
- any lost profits or indirect, punitive, special or consequential damages or losses, even if STOXX knows that they might occur.

The licensing relating to the use of the Index and trademark referred to above by Royal Bank of Canada is solely for the benefit of Royal Bank of Canada, and not for any other third parties.

Historical Closing Levels of the Index

Since its inception, the level of the Index has experienced significant fluctuations. Any historical upward or downward trend in the closing level of the Index during any period shown below is not an indication that the closing level of the Index is more or less likely to increase or decrease at any time during the term of the securities. The historical levels of the Index do not give an indication of future performance of the Index. We cannot make any assurance that the future performance of the Index or the trading prices of the common stocks underlying the Index will result in holders of the securities receiving a positive total return on their investment.

We obtained the closing levels of the Index listed below from Bloomberg Financial Markets without independent verification. The actual levels of the Index at or near maturity of the securities may bear little relation to the historical levels shown below.

The following graph sets forth the daily closing levels of the Index for the period from January 1, 2007 to August 31, 2017, and the table below sets forth the published quarterly high, low and quarter end closing level of the Index for the same period. This historical data on the Index is not indicative of the future level of the Index or what the market value of the securities may be. Any historical upward or downward trend in the level of the Index during any period set forth below is not any indication that the level of the Index is more or less likely to increase or decrease at any time during the term of the securities.

Quarter/Period – Start Date	Quarter/Period – End Date	High Closing Level of the Index	Low Closing Level of the Index	Quarter/Period – End Closing Level of the Index
1/1/2007	3/30/2007	4,272.32	3,906.15	4,181.03
4/1/2007	6/29/2007	4,556.97	4,189.55	4,489.77
7/1/2007	9/28/2007	4,557.57	4,062.33	4,381.71
10/1/2007	12/31/2007	4,489.79	4,195.58	4,399.72
1/1/2008	3/31/2008	4,339.23	3,431.82	3,628.06
4/1/2008	6/30/2008	3,882.28	3,340.27	3,352.81
7/1/2008	9/30/2008	3,445.66	3,000.83	3,038.20
10/1/2008	12/31/2008	3,113.82	2,165.91	2,447.62
1/1/2009	3/31/2009	2,578.43	1,809.98	2,071.13
4/1/2009	6/30/2009	2,537.35	2,097.57	2,401.69
7/1/2009	9/30/2009	2,899.12	2,281.47	2,872.63
10/1/2009	12/31/2009	2,992.08	2,712.30	2,964.96
1/1/2010	3/31/2010	3,017.85	2,631.64	2,931.16
4/1/2010	6/30/2010	3,012.65	2,488.50	2,573.32
7/1/2010	9/30/2010	2,827.27	2,507.83	2,747.90
10/1/2010	12/31/2010	2,890.64	2,650.99	2,792.82
1/1/2011	3/31/2011	3,068.00	2,721.24	2,910.91
4/1/2011	6/30/2011	3,011.25	2,715.88	2,848.53
7/1/2011	9/30/2011	2,875.67	1,995.01	2,179.66
10/1/2011	12/31/2011	2,476.92	2,090.25	2,316.55
1/1/2012	3/30/2012	2,608.42	2,286.45	2,477.28
4/1/2012	6/30/2012	2,501.18	2,068.66	2,264.72
7/1/2012	9/30/2012	2,594.56	2,151.54	2,454.26
10/1/2012	12/31/2012	2,659.95	2,427.32	2,635.93
1/1/2013	3/31/2013	2,749.27	2,570.52	2,624.02
4/1/2013	6/30/2013	2,835.87	2,511.83	2,602.59
7/1/2013	9/30/2013	2,936.20	2,570.76	2,893.15
10/1/2013	12/31/2013	3,111.37	2,902.12	3,109.00
1/1/2014	3/31/2014	3,172.43	2,962.49	3,161.60
4/1/2014	6/30/2014	3,314.80	3,091.52	3,228.24
7/1/2014	9/30/2014	3,289.75	3,006.83	3,225.93
10/1/2014	12/31/2014	3,277.38	2,874.65	3,146.43
1/1/2015	3/31/2015	3,731.35	3,007.91	3,697.38
4/1/2015	6/30/2015	3,828.78	3,424.30	3,424.30
7/1/2015	9/30/2015	3,686.58	3,019.34	3,100.67
10/1/2015	12/31/2015	3,506.45	3,069.05	3,267.52

1/1/2016	3/31/2016	3,178.01	2,680.35	3,004.93
4/1/2016	6/30/2016	3,151.69	2,697.44	2,864.74
7/1/2016	9/30/2016	3,091.66	2,761.37	3,002.24
10/1/2016	12/31/2016	3,290.52	2,954.53	3,290.52

	(4)	0		0	47	43	
Acquisition of treasury stock (14,221 shares)	0	0		0	0	(245)	(245)
Balance, March 31, 2016	$ 437	$	124,548	$9,855	$ 4,434	$ (1,027)	$138,247

The Notes to Consolidated Financial Statements are an integral part of these statements.

6

Table of Contents

Consolidated Statements of Cash Flows (Unaudited)
ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARY

(Dollars in thousands)	Three Months Ended March 31, 2016	March 31, 2015
Cash flows from operating activities		
Net income	$2,580	$2,462
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premiums on securities available for sale	1,372	1,534
Depreciation and amortization	741	741
Provision for loan losses	0	0
Stock-based compensation	240	134
Gain on sales of loans originated for sale	(547)	(415)
Mortgage loans originated for sale	(18,041)	(16,023)
Proceeds from sales of loans originated for sale	20,839	14,420
Net gain on disposal of other real estate owned	(55)	(7)
Writedown of other real estate owned	51	0
Net loss on disposal of premises and equipment	25	0
Deferred income taxes	728	726
Investment securities gains	(1,420)	(1,529)
Earnings on cash surrender value of life insurance	(268)	(229)
Decrease in accrued interest receivable	263	48
Increase in accrued interest payable and other liabilities	(387)	(116)
Other, net	(1,037)	(986)
Net cash provided by operating activities	5,084	760
Cash flows from investing activities		
Proceeds from sales of available for sale securities	64,743	41,382
Maturities, repayments and calls of available for sale securities	6,816	7,838
Purchases of available for sale securities	0	(19,859)
Net redemptions of restricted investments in bank stocks	2,450	672
Net increase in loans	(23,262)	(23,842)
Purchases of bank premises and equipment	(6,321)	(126)
Improvements to other real estate owned	(35)	0
Proceeds from disposal of other real estate owned	305	253
Net cash provided by investing activities	44,696	6,318
Cash flows from financing activities		
Net increase (decrease) in deposits	16,209	(3,948)
Net decrease in short term purchased funds	(26,463)	(11,470)
Proceeds from long-term debt	0	20,000
Payments on long-term debt	(82)	(10,078)
Dividends paid	(664)	0
Net proceeds from issuance of common stock	0	47
Acquisition of treasury stock	(245)	0
Issuance of treasury stock	40	0
Net cash (used in) financing activities	(11,205)	(5,449)
Net increase in cash and cash equivalents	38,575	1,629
Cash and cash equivalents at beginning of period	28,340	31,409
Cash and cash equivalents at end of period	$66,915	$33,038

Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$1,301	$923
Income taxes	0	0
Supplemental schedule of noncash investing activities:		
Other real estate acquired in settlement of loans	$51	$745

The Notes to Consolidated Financial Statements are an integral part of these statements.

7

Table of Contents

Notes to Consolidated Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations – Orrstown Financial Services, Inc. (the “Company”) is a bank holding company (that has elected status as a financial holding company with the Board of Governors of the Federal Reserve System (the “FRB”)) whose primary activity consists of supervising its wholly-owned subsidiary, Orrstown Bank (the “Bank”). The Company operates through its office in Shippensburg, Pennsylvania. The Bank provides services through its network of 21 offices in Cumberland, Franklin, Lancaster, and Perry Counties of Pennsylvania and in Washington County, Maryland. The Bank engages in lending services for commercial, residential, commercial mortgages, construction, municipal, and various forms of consumer lending. Deposit services include checking, savings, time, and money market deposits. The Bank also provides investment and brokerage services through its Orrstown Financial Advisors division. The Company and the Bank are subject to the regulation of certain federal and state agencies and undergo periodic examinations by such regulatory authorities.

Basis of Presentation – The unaudited condensed consolidated financial statements of the Company and its subsidiary are presented for the three months ended March 31, 2016 and 2015 and have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. However, unaudited information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, considered necessary for a fair presentation of the financial position, results of operations and cash flows for the interim period. Information presented at December 31, 2015 is condensed from audited year-end financial statements. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K for the year ended December 31, 2015. The consolidated financial statements include the accounts of the Company and the Bank. Operating results for the three months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. All significant intercompany transactions and accounts have been eliminated.

Use of Estimates – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Subsequent Events – GAAP establishes standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The subsequent events principle sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and specifies the disclosures that should be made about events or transactions that occur after the balance sheet date.

Concentration of Credit Risk – The Company generally grants commercial, residential, construction, municipal, and various forms of consumer lending to customers in its market area. Although the Company maintains a diversified loan portfolio, a significant portion of its customers’ ability to honor their contracts is dependent upon economic sectors for commercial real estate, including office space, retail strip centers, multi-family and hospitality, residential building operators, sales finance, sub-dividers and developers. Management evaluates each customer’s creditworthiness on a case-by-case basis. The amount of collateral obtained, if collateral is deemed necessary by the Company upon the extension of credit, is based on management’s credit evaluation of the customer. Collateral held varies, but generally includes real estate and equipment.

The types of securities the Company invests in are included in Note 2, “Securities Available for Sale” and the type of lending the Company engages in are included in Note 3, “Loans Receivable and Allowance for Loan Losses.”

Cash and Cash Equivalents – For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash, balances due from banks, federal funds sold and interest bearing deposits due on demand, all of which have original maturities of 90 days or less. Net cash flows are reported for customer loan and deposit transactions, loans held for sale and redemption (purchases) of restricted investments in bank stocks, and short-term borrowings.

Restricted Investments in Bank Stocks – Restricted investments in bank stocks, which represents required investments in the common stock of correspondent banks, is carried at cost as of March 31, 2016 and December 31, 2015, and consists of common stock of the Federal Reserve Bank of Philadelphia ("Federal Reserve Bank"), Atlantic Community Bankers Bank and the Federal Home Loan Bank of Pittsburgh ("FHLB").

Management evaluates the restricted investment in bank stocks for impairment in accordance with Accounting Standard Codification (ASC) Topic 942, Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or

Table of Contents

Finance the Activities of Others. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the correspondent bank as compared to the capital stock amount for the correspondent bank and the length of time this situation has persisted, (2) commitments by the correspondent bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of the correspondent bank, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the correspondent bank.

Management believes no impairment charge is necessary related to the restricted investments in bank stocks as of March 31, 2016. However, security impairment analysis is completed quarterly and the determination that no impairment had occurred as of March 31, 2016 is no assurance that impairment may not occur in the future.

Securities – Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. "Trading" securities are recorded at fair value with changes in fair value included in earnings. As of March 31, 2016 and December 31, 2015, the Company had no held to maturity or trading securities. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities and approximate the level yield method. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

The Company had no debt securities it deemed to be other than temporarily impaired at March 31, 2016 or December 31, 2015.

The Company's securities are exposed to various risks, such as interest rate risk, market risk, and credit risks. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment assets reported in the consolidated financial statements.

Loans Held for Sale – Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value (LOCM). Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in non-interest income.

Loans – The Company grants commercial, residential, commercial mortgage, construction, municipal, mortgage and various forms of consumer loans to its customers located principally in south-central Pennsylvania and northern Maryland. The ability of the Company's debtors to honor their contracts is dependent largely upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and amortized as a yield adjustment over the respective term of the loan.

For all classes of loans, the accrual of interest income on loans, including impaired loans, generally ceases when principal or interest is past due 90 days or more or immediately if, in the opinion of management, full collection is unlikely. Interest will continue to accrue on loans past due 90 days or more if the collateral is adequate to cover principal and interest, and the loan is in the process of collection. Interest accrued, but not collected, as of the date of placement on nonaccrual status, is reversed and charged against current interest income, unless fully collateralized. Subsequent payments received are either applied to the outstanding principal balance or recorded as interest income, depending upon management's assessment of the ultimate collectability of principal. Loans are returned to accrual status, for all loan classes, when all the principal and interest amounts contractually due are brought current, the loan has performed in accordance with the contractual terms of the note for a reasonable period of time, generally six months, and the ultimate collectability of the total contractual principal and interest is reasonably assured. Past due status is based on contractual terms of the loan.

Loans, the terms of which are modified, are classified as troubled debt restructurings ("TDRs") if a concession was granted in connection with the modification, for legal or economic reasons, related to the debtor's financial difficulties. Concessions granted under a TDR typically involve a temporary deferral of scheduled loan payments, an extension of a loan's stated maturity date, a temporary reduction in interest rates, or granting of an interest rate below market rates given the risk of the transaction. If a modification occurs while the loan is on accruing status, it will continue to accrue interest under the modified terms. Nonaccrual TDRs may be restored to accrual status if scheduled principal and interest payments, under the modified terms, are current for six months after modification, and the borrower continues to demonstrate its ability to meet the modified terms. TDRs are evaluated individually for impairment on a quarterly basis including monitoring of performance according to their modified terms.

Allowance for Loan Losses – The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

See Note 3, "Loans Receivable and Allowance for Loan Losses," for additional details.

Loan Commitments and Related Financial Instruments – Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Loans Serviced – The Bank administers secondary market mortgage programs available through the FHLB and the Federal National Mortgage Association and offers residential mortgage products and services to customers. The Bank originates single-family residential mortgage loans for immediate sale in the secondary market, and retains the servicing of those loans. At March 31, 2016 and December 31, 2015, the balance of loans serviced for others was $324,221,000 and $317,793,000.

Transfers of Financial Assets – Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Cash Surrender Value of Life Insurance – The Company has purchased life insurance policies on certain employees. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Premises and Equipment – Buildings, improvements, equipment, furniture and fixtures are carried at cost less accumulated depreciation and amortization. Land is carried at cost. Depreciation and amortization has been provided generally on the straight-line method and is computed over the estimated useful lives of the various assets as follows: buildings and improvements, including leasehold improvements – 10 to 40 years; and furniture and equipment – 3 to 15 years. Repairs and maintenance are charged to operations as incurred, while major additions and improvements are capitalized. Gain or loss on retirement or disposal of individual assets is recorded as income or expense in the period of retirement or disposal.

Intangible Assets – Intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights. The Company's intangible assets have finite lives and are amortized, on a straight line basis, over their estimated lives, generally 10 years for deposit premiums and 15 years for customer lists.

Table of Contents

Mortgage Servicing Rights – The estimated fair value of mortgage servicing rights (MSRs) related to loans sold and serviced by the Company is recorded as an asset upon the sale of such loans. MSRs are amortized as a reduction to servicing income over the estimated lives of the underlying loans. MSRs are evaluated periodically for impairment, by comparing the carrying amount to estimated fair value. Fair value is determined periodically through a discounted cash flows valuation performed by a third party. Significant inputs to the valuation include expected servicing income, net of expense, the discount rate and the expected life of the underlying loans. To the extent the amortized cost of the MSRs exceeds their estimated fair values, a valuation allowance is established for such impairment through a charge against servicing income on the consolidated statement of income. If the Company determines, based on subsequent valuations, that impairment no longer exists or is reduced, the valuation allowance is reduced through a credit to earnings. The balance of mortgage servicing rights was $2,710,000 and $2,672,000 as of March 31, 2016 and December 31, 2015, and is included in other assets.

Foreclosed Real Estate – Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell the underlying collateral. Capitalized costs include any costs that significantly improve the value of the properties. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less estimated costs to sell. Foreclosed real estate totaled $495,000 and $710,000 as of March 31, 2016 and December 31, 2015 and is included in other assets.

Investments in Real Estate Partnerships – The Company currently has a 99% limited partner interest in several real estate partnerships in central Pennsylvania. These investments are affordable housing projects which entitle the Company to tax deductions and credits that expire through 2025. The Company accounts for its investments in affordable housing projects under the proportional amortization method when the criteria is met, which is limited to one investment entered into in 2015. Investments prior to 2015 did not meet the criteria, and are accounted for under the equity method of accounting. The recorded investment in these real estate partnerships, included in other assets in the balance sheet, totaled $5,328,000 and $5,450,000 as of March 31, 2016 and December 31, 2015, of which $2,150,000 and $2,205,000 will be accounted for under the proportional amortization method, respectively. Losses of $89,000 and $85,000 were recorded for the three months ended March 31, 2016 and 2015 and are included in other noninterest income. Losses on the investments accounted for under the proportional amortization method of $33,000, net of federal income tax benefit, is netted against income tax expense for the three months ended March 31, 2016. During the three months ended 2016 and 2015, the Company recognized federal tax credits from the projects totaling $184,000, and $119,000, which is included in income tax expense.

Advertising – The Company follows the policy of charging costs of advertising to expense as incurred. Advertising expense was $151,000 and $112,000 for the three months ended March 31, 2016 and 2015.

Securities Sold Under Agreements to Repurchase (“Repurchase Agreements”) – The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities which are included in short-term borrowings. Under these Repurchase Agreements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these Repurchase Agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company’s consolidated balance sheet, while the securities underlying the Repurchase Agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the Repurchase Agreement liabilities. In addition, as the Company does not enter into reverse Repurchase Agreements, there is no such offsetting to be done with the Repurchase Agreements.

The right of setoff for a Repurchase Agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the Repurchase Agreement should the Company be in default (e.g., fails to make an interest payment to the counterparty). For the Repurchase Agreements, the collateral is held by the Company in a segregated custodial account under a third party agreement. Repurchase agreements are secured by U.S. Government Sponsored Enterprises mortgage-backed securities and mature overnight.

Stock Compensation Plans – The Company has stock compensation plans that cover employees and non-employee directors. Stock compensation accounting guidance (Financial Accounting Standards Board ("FASB") ASC 718, Compensation – Stock Compensation) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost is measured based on the grant date fair value of the stock award, including a Black-Scholes model for stock options. Compensation cost for all stock awards is calculated and recognized over the employees' service period, generally defined as the vesting period.

Income Taxes – The Company accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, Income Taxes). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of

Table of Contents

the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. The Company recognizes interest and penalties, if any, on income taxes as a component of income tax expense.

Loss Contingencies – Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Treasury Stock – Common stock shares repurchased are recorded as treasury stock at cost.

Earnings Per Share – Basic earnings per share represent net income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Restricted stock awards are included in weighted average common shares outstanding as they are earned. Diluted earnings per share reflect the additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company related solely to outstanding stock options and restricted stock awards.

Treasury shares are not deemed outstanding for earnings per share calculations.

Comprehensive Income – Comprehensive income consists of net income and other comprehensive income. Other comprehensive income is limited to unrealized gains on securities available for sale for all years presented. The component of accumulated other comprehensive income, net of taxes, at March 31, 2016 and December 31, 2015 consisted of unrealized gains on securities available for sale and totaled $4,434,000 and $1,199,000.

Fair Value of Financial Instruments – Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 9. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Segment Reporting – The Company only operates in one significant segment – Community Banking. The Company's non-banking activities are insignificant to the consolidated financial statements.

Reclassification – Certain amounts in the 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Recent Accounting Pronouncements – In May 2014, the FASB issued ASU 2014-9, Revenue from Contracts with Customers (Topic 606). ASU 2014-9, as amended, creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. These amendments are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period.

The Company is evaluating the impact of this standard on its financial position and results of operations.
In April 2015, the FASB issued ASU No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, as subsequently amended by ASU No. 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. The update simplifies the presentation of debt issuance costs by requiring that debt issuance costs be presented in the balance sheet as a direct deduction from the

Table of Contents

carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this update. Further, the amendment indicates the SEC would not object to a ratable amortization of debt issuance costs on line-of-credit arrangements. These amendments were effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The Company's adoption of this standard on January 1, 2016 did not have a significant impact on the Company's operating results or financial condition.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The update provides updated accounting and reporting requirements for both public and non-public entities. The most significant provisions that will impact the Company is: 1) equity securities available for sale will be measured at fair value, with the changes in fair value recognized in the income statement; 2) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments at amortized cost on the balance sheet; 3) utilization of the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 4) require separate presentation of both financial assets and liabilities by measurement category and form of financial asset on the balance sheet or accompanying notes to the financial statements. The update will be effective for interim and annual periods beginning after December 15, 2017, using a cumulative-effect adjustment to the balance sheet as of the beginning of the year of adoption. Early adoption is not permitted. The Company is evaluating the impact of this standard on its financial position and results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The update provides updated accounting and reporting requirements, which, among other things, requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. The Company anticipates that the impact on the balance sheet will result in an increase in assets and liabilities for its right of use assets and related lease liabilities for those leases that are outstanding at the date of adoption, however, it does not anticipate it will have a material impact on its results of operations. We are currently evaluating the other effects of adoption of this new standard on our financial position, including regulatory capital.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting (Topic 718). The update will require recognition of the income tax effects of share-based awards in the income statement when the awards vest or are settled, eliminating the additional paid-in-capital pools. The guidance will be effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The Company does not anticipate this update will have a material impact on its financial position or results of operations.

Table of Contents

NOTE 2. SECURITIES AVAILABLE FOR SALE

At March 31, 2016 and December 31, 2015, the investment securities portfolio was comprised exclusively of securities classified as “available for sale,” resulting in investment securities being carried at fair value. The amortized cost and fair values of investment securities available for sale at March 31, 2016 and December 31, 2015 were:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2016				
U.S. Government Agencies	$ 45,072	$ 188	$ 121	$45,139
States and political subdivisions	124,302	5,246	367	129,181
U.S. Government Sponsored Enterprises (GSE) residential mortgage-backed securities	129,219	1,556	0	130,775
GSE residential collateralized mortgage obligations (CMOs)	14,040	384	20	14,404
Private label CMOs	8,086	0	68	8,018
Total debt securities	320,719	7,374	576	327,517
Equity securities	50	23	0	73
Totals	$ 320,769	$ 7,397	$ 576	$327,590
December 31, 2015				
U.S. Government Agencies	$ 47,209	$ 200	$ 182	$47,227
States and political subdivisions	124,421	2,483	943	125,961
GSE residential mortgage-backed securities	132,389	229	269	132,349
GSE residential CMOs	15,668	215	40	15,843
GSE commercial CMOs	63,598	735	563	63,770
Private label CMOs	8,944	0	43	8,901
Total debt securities	392,229	3,862	2,040	394,051
Equity securities	50	23	0	73
Totals	$ 392,279	$ 3,885	$ 2,040	$394,124

14

Table of Contents

The following table shows gross unrealized losses and fair value of the Company's available for sale securities that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position at March 31, 2016 and December 31, 2015:

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2016						
U.S. Government Agencies	$19,951	$ 121	$0	$ 0	$19,951	$ 121
States and political subdivisions	1,205	2	5,313	365	6,518	367
GSE residential collateralized mortgage obligations (CMOs)	0	0	2,555	20	2,555	20
Private label CMOs	8,018	68	0	0	8,018	68
Total temporarily impaired securities	$29,174	$ 191	$7,868	$ 385	$37,042	$ 576
December 31, 2015						
U.S. Government Agencies	$27,640	$ 182	$0	$ 0	$27,640	$ 182
States and political subdivisions	30,252	373	14,139	570	44,391	943
GSE residential mortgage-backed securities	82,911	269	0	0	82,911	269
GSE residential CMOs	0	0	4,237	40	4,237	40
GSE commercial CMOs	33,606	563	0	0	33,606	563
Private label CMOs	8,901	43	0	0	8,901	43
Total temporarily impaired securities	$183,310	$ 1,430	$18,376	$ 610	$201,686	$ 2,040

The Company had 11 securities and 53 securities at March 31, 2016 and December 31, 2015 in which the amortized cost exceed their values, as discussed below.

U.S. Agencies and Government Sponsored Enterprises (GSE). Six U.S. Agencies and GSE securities, including mortgage-backed securities and collateralized mortgage obligations, have amortized costs which exceed their fair values, four of which are in the less than 12 months, and two have amortized costs which exceed their fair value for more than 12 months at March 31, 2016. At December 31, 2015, the Company had 29 U.S. Government Agencies and GSE securities, including mortgage-backed and collateralized mortgage obligations with unrealized losses, 25 GSE securities have amortized costs which exceed their fair values for less than 12 months, and four have amortized costs which exceed their fair values for more than 12 months. These unrealized losses have been caused by a rise in interest rates or widening of spreads from the time the securities were purchased. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the par value basis of the investments. Because the Company did not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2016 or at December 31, 2015.

State and Political Subdivisions. Two state and political subdivision securities have amortized costs which exceeded their fair values, one in the less than 12 months, and one in the more than 12 months category at March 31, 2016. At December 31, 2015, 21 state and political subdivision securities have an amortized cost which exceeds their fair value, 16 of which are in the less than 12 months category, and five have amortized costs which exceed their fair value for more than 12 months. These unrealized losses have been caused by a rise in interest rates or a widening of spreads from the time the securities were purchased. Management considers the investment rating, the state of the issuer of the security and other credit support in determining whether the security is other-than-temporarily impaired. Because the Company did not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2016 or at December 31, 2015.

Private Label. Three private label collateralized mortgage obligations have unrealized losses, all of which were in the less than 12 months category at March 31, 2016. At December 31, 2015, three private label securities have an amortized cost which exceeds their fair value for less than 12 months. These unrealized losses have been caused by a rise in interest rates from the time the securities were purchased. Because the Company does not intend to sell the investments and it is not more likely than

Table of Contents

not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2016 or at December 31, 2015.

The amortized cost and fair values of securities available for sale at March 31, 2016 by contractual maturity are shown below. Contractual maturities will differ from expected maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$365	$366
Due after one year through five years	3,232	3,381
Due after five years through ten years	62,821	65,147
Due after ten years	102,956	105,426
Mortgage-backed securities and collateralized mortgage obligations	151,345	153,197
Total debt securities	320,719	327,517
Equity securities	50	73
	$320,769	$327,590

Gross gains on the sales of securities were $1,468,000 and $1,553,000 for the three months ended March 31, 2016 and 2015. Gross losses on securities available for sale were $48,000 and $24,000 for the three months ended March 31, 2016 and 2015.

Securities with a fair value of $254,252,000 and $250,397,000 at March 31, 2016 and December 31, 2015 were pledged to secure public funds and for other purposes as required or permitted by law.

NOTE 3. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The Company’s loan portfolio is broken down into segments to an appropriate level of disaggregation to allow management to monitor the performance by the borrower and to monitor the yield on the portfolio. Consistent with ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses, the segments were further broken down into classes, to allow for differing risk characteristics within a segment.

The risks associated with lending activities differ among the various loan classes, and are subject to the impact of changes in interest rates, market conditions of collateral securing the loans, and general economic conditions. All of these factors may adversely impact the borrower’s ability to repay its loans, and impact the associated collateral.

The Company has various types of commercial real estate loans which have differing levels of credit risk associated with them. Owner-occupied commercial real estate loans are generally dependent upon the successful operation of the borrower’s business, with the cash flows generated from the business being the primary source of repayment of the loan. If the business suffers a downturn in sales or profitability, the borrower’s ability to repay the loan could be in jeopardy.

Non-owner occupied and multi-family commercial real estate loans and non-owner occupied residential loans present a different credit risk to the Company than owner-occupied commercial real estate loans, as the repayment of the loan is dependent upon the borrower’s ability to generate a sufficient level of occupancy to produce rental income that exceeds debt service requirements and operating expenses. Lower occupancy or lease rates may result in a reduction in cash flows, which hinders the ability of the borrower to meet debt service requirements, and may result in lower collateral values. The Company generally recognizes that greater risk is inherent in these credit relationships as compared to owner-occupied loans mentioned above.

Acquisition and development loans consist of 1-4 family residential construction and commercial and land development loans. The risk of loss on these loans is largely dependent on the Company’s ability to assess the property’s value at the completion of the project, which should exceed the property’s construction costs. During the construction phase, a number of factors could potentially negatively impact the collateral value, including cost overruns, delays in completing the project, competition, and real estate market conditions which may change based on the supply of similar properties in the area. In the

Table of Contents

event the collateral value at the completion of the project is not sufficient to cover the outstanding loan balance, the Company must rely upon other repayment sources, including the guarantors of the project or other collateral securing the loan.

Commercial and industrial loans include advances to local and regional businesses for general commercial purposes and include permanent and short-term working capital, machinery and equipment financing, and may be either in the form of lines of credit or term loans. Although commercial and industrial loans may be unsecured for our highest-rated borrowers, the majority of these loans are secured by the borrower's accounts receivable, inventory and machinery and equipment. In a significant number of these loans, the collateral also includes the business real estate or the business owner's personal real estate or assets. Commercial and industrial loans present credit exposure to the Company, as they are more susceptible to risk of loss during a downturn in the economy, as borrowers may have greater difficulty in meeting their debt service requirements and the value of the collateral may decline. The Company attempts to mitigate this risk through its underwriting standards, including evaluating the credit worthiness of the borrower and, to the extent available, credit ratings on the business. Additionally, monitoring of the loans through annual renewals and meetings with the borrowers are typical. However, these procedures cannot eliminate the risk of loss associated with commercial and industrial lending.

Municipal loans consist of extensions of credit to municipalities and school districts within the Company's market area. These loans generally present a lower risk than commercial and industrial loans, as they are generally secured by the municipality's full taxing authority, by revenue obligations, or by its ability to raise assessments on its customers for a specific utility.

The Company originates loans to its retail customers, including fixed-rate and adjustable rate first lien mortgage loans with the underlying 1-4 family owner-occupied residential property securing the loan. The Company's risk exposure is minimized in these types of loans through the evaluation of the credit worthiness of the borrower, including credit scores and debt-to-income ratios, and underwriting standards which limit the loan-to-value ratio to generally no more than 80% upon loan origination, unless the borrower obtains private mortgage insurance.

Home equity loans, including term loans and lines of credit, present a slightly higher risk to the Company than 1-4 family first liens, as these loans can be first or second liens on 1-4 family owner occupied residential property, but can have loan-to-value ratios of no greater than 90% of the value of the real estate taken as collateral. The credit worthiness of the borrower is considered including credit scores and debt-to-income ratios, which generally cannot exceed 43%.

Installment and other loans' credit risk are mitigated through prudent underwriting standards, including the evaluation of the credit worthiness of the borrower through credit scores and debt-to-income ratios, and if secured, the collateral value of the assets. As these loans can be unsecured or secured by assets the value of which may depreciate quickly or may fluctuate, they typically present a greater risk to the Company than 1-4 family residential loans.

The loan portfolio, excluding residential loans held for sale, broken out by class, as of March 31, 2016 and December 31, 2015 was as follows:

(Dollars in thousands)	March 31, 2016	December 31, 2015
Commercial real estate:		
Owner-occupied	$106,464	$103,578
Non-owner occupied	154,731	145,401
Multi-family	37,664	35,109
Non-owner occupied residential	54,834	54,175
Acquisition and development:		
1-4 family residential construction	7,270	9,364
Commercial and land development	42,245	41,339
Commercial and industrial	77,277	73,625
Municipal	62,302	57,511
Residential mortgage:		
First lien	125,706	126,022

Home equity - term	16,578	17,337
Home equity - lines of credit	111,770	110,731
Installment and other loans	7,862	7,521
	$804,703	$781,713

17

Table of Contents

In order to monitor ongoing risk associated with its loan portfolio and specific loans within the segments, management uses an internal grading system. The first several rating categories, representing the lowest risk to the Bank, are combined and given a “Pass” rating. Management generally follows regulatory definitions in assigning criticized ratings to loans, including special mention, substandard, doubtful or loss. The “Special Mention” category includes loans that have potential weaknesses that may, if not monitored or corrected, weaken the asset or inadequately protect the Bank’s position at some future date. These assets pose elevated risk, but their weakness does not yet justify a more severe, or classified rating. “Substandard” loans are classified as they have a well-defined weakness, or weaknesses that jeopardize liquidation of the debt. These loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. “Substandard” loans include loans that management has determined not to be impaired, as well as loans considered to be impaired. 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 of loss is deferred. “Loss” assets are considered uncollectible, as the underlying borrowers are often in bankruptcy, have suspended debt repayments, or have ceased business operations. Once a loan is classified as “Loss,” there is little prospect of collecting the loan’s principal or interest and it is generally written off.

The Bank has a loan review policy and program which is designed to identify and manage risk in the lending function. The Enterprise Risk Management (“ERM”) Committee, comprised of executive officers and loan department personnel, is charged with the oversight of overall credit quality and risk exposure of the Bank’s loan portfolio. This includes the monitoring of the lending activities of all Bank personnel with respect to underwriting and processing new loans and the timely follow-up and corrective action for loans showing signs of deterioration in quality. The loan review program provides the Bank with an independent review of the Bank’s loan portfolio on an ongoing basis. Generally, consumer and residential mortgage loans are included in the “Pass” categories unless a specific action, such as extended delinquencies, bankruptcy, repossession or death of the borrower occurs, which heightens awareness as to a possible credit event.

Internal loan reviews are completed annually on all commercial relationships with a committed loan balance in excess of $500,000, which includes confirmation of risk rating by the appropriate credit authority, including Credit Administration for loans in excess of $1,000,000. In addition, all relationships greater than $250,000 rated Substandard, Doubtful or Loss are reviewed and corresponding risk ratings are reaffirmed by the Bank's Problem Loan Committee, with subsequent reporting to the ERM Committee.

Table of Contents

The following summarizes the Bank’s ratings based on its internal risk rating system as of March 31, 2016 and December 31, 2015:

(Dollars in thousands)	Pass	Special Mention	Non-Impaired Substandard	Impaired - Substandard	Doubtful	Total
March 31, 2016						
Commercial real estate:						
Owner-occupied	$98,959	$1,771	$ 3,705	$ 2,029	$ 0	$106,464
Non-owner occupied	134,518	12,419	108	7,686	0	154,731
Multi-family	34,863	1,763	813	225	0	37,664
Non-owner occupied residential	51,490	1,282	1,231	792	39	54,834
Acquisition and development:						
1-4 family residential construction	7,270	0	0	0	0	7,270
Commercial and land development	41,105	215	922	3	0	42,245
Commercial and industrial	74,651	1,352	560	714	0	77,277
Municipal	62,302	0	0	0	0	62,302
Residential mortgage:						
First lien	120,882	0	44	4,780	0	125,706
Home equity - term	16,478	0	1	99	0	16,578
Home equity - lines of credit	110,850	251	102	567	0	111,770
Installment and other loans	7,846	0	0	9	7	7,862
	$761,214	$19,053	$ 7,486	$ 16,904	$ 46	$804,703
December 31, 2015						
Commercial real estate:						
Owner-occupied	$96,715	$1,124	$ 3,630	$ 2,109	$ 0	$103,578
Non-owner occupied	125,043	12,394	108	7,856	0	145,401
Multi-family	31,957	1,779	1,140	233	0	35,109
Non-owner occupied residential	50,601	1,305	1,374	895	0	54,175
Acquisition and development:						
1-4 family residential construction	9,364	0	0	0	0	9,364
Commercial and land development	40,181	219	934	5	0	41,339
Commercial and industrial	70,967	1,380	544	734	0	73,625
Municipal	57,511	0	0	0	0	57,511
Residential mortgage:						
First lien	121,214	0	0	4,808	0	126,022
Home equity - term	17,234	0	0	103	0	17,337
Home equity - lines of credit	109,731	230	180	590	0	110,731
Installment and other loans	7,504	0	0	17	0	7,521
	$738,022	$18,431	$ 7,910	$ 17,350	$ 0	$781,713

Classified loans may also be evaluated for impairment. For commercial real estate, acquisition and development and commercial and industrial loans, a loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Generally, loans that are more than 90 days past due are deemed impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed to determine if the loan should be placed on nonaccrual status. Nonaccrual loans in the commercial and

19

commercial real estate portfolios and any TDRs are, by definition, deemed to be impaired. Impairment is measured on a loan-by-loan basis for commercial, construction and restructured loans by either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. For loans that are deemed to be impaired for extended periods of time, periodic updates on fair values are obtained, which may include updated appraisals. The updated fair values are incorporated into the impairment analysis as of the next reporting period.

Loan charge-offs, which may include partial charge-offs, are taken on an impaired loan that is collateral dependent if the loan's carrying balance exceeds its collateral's appraised value; the loan has been identified as uncollectible; and it is deemed to be a confirmed loss. Typically, impaired loans with a charge-off or partial charge-off will continue to be considered impaired, unless the note is split into two, and management expects the performing note to continue to perform and is adequately secured. The second, or non-performing note, would be charged-off. Generally, an impaired loan with a partial charge-off may continue to have an impairment reserve on it after the partial charge-off, if factors warrant.

As of March 31, 2016 and December 31, 2015, nearly all of the Company's impaired loans' extent of impairment were measured based on the estimated fair value of the collateral securing the loan, except for TDRs. By definition, TDRs are considered impaired. All restructured loan impairments were determined based on discounted cash flows for those loans classified as TDRs and still accruing interest. For real estate loans, collateral generally consists of commercial real estate, but in the case of commercial and industrial loans, it would also consist of accounts receivable, inventory, equipment or other business assets. Commercial and industrial loans may also have real estate collateral.

According to policy, updated appraisals are generally required every 18 months for classified loans in excess of $250,000. The "as is value" provided in the appraisal is often used as the fair value of the collateral in determining impairment, unless circumstances, such as subsequent improvements, approvals, or other circumstances dictate that another value provided by the appraiser is more appropriate.

Generally, impaired loans secured by real estate are measured at fair value using certified real estate appraisals that had been completed within the last year. Appraised values are further discounted for estimated costs to sell the property and other selling considerations to arrive at the property's fair value. In those situations in which it is determined an updated appraisal is not required for loans individually evaluated for impairment, fair values are based on one or a combination of the following approaches. In those situations in which a combination of approaches is considered, the factor that carries the most consideration will be the one management believes is warranted. The approaches are as follows:

- Original appraisal – if the original appraisal provides a strong loan-to-value ratio (generally 70% or lower) and, after consideration of market conditions and knowledge of the property and area, it is determined by the Credit Administration staff that there has not been a significant deterioration in the collateral value, the original certified appraised value may be used. Discounts as deemed appropriate for selling costs are factored into the appraised value in arriving at fair value.
- Discounted cash flows – in limited cases, discounted cash flows may be used on projects in which the collateral is liquidated to reduce the borrowings outstanding, and is used to validate collateral values derived from other approaches.

Collateral on certain impaired loans is not limited to real estate, and may consist of accounts receivable, inventory, equipment or other business assets. Estimated fair values are determined based on borrowers' financial statements, inventory ledgers, accounts receivable agings or appraisals from individuals with knowledge in the business. Stated balances are generally discounted for the age of the financial information or the quality of the assets. In determining fair value, liquidation discounts are applied to this collateral based on existing loan evaluation policies.

The Company distinguishes Substandard loans on both an impaired and non-impaired basis, as it places less emphasis on a loan's classification, and increased reliance on whether the loan was performing in accordance with the contractual terms. A "Substandard" classification does not automatically meet the definition of "impaired." A "Substandard" loan is one that is inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Extensions of credit so classified have well-defined weaknesses which may jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual extensions of credit classified as "Substandard." As a result, the Company’s methodology includes an evaluation of certain accruing commercial real estate, acquisition and development and commercial and industrial loans rated “Substandard” to be collectively evaluated for impairment as opposed to evaluating these loans individually for impairment. Although we believe these loans have well defined weaknesses and meet the definition of “Substandard,” they are generally performing and management has concluded

Table of Contents

that it is likely it will be able to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement.

Larger groups of smaller balance homogeneous loans are collectively evaluated for impairment. Generally, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

The following table summarizes impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not required as of March 31, 2016 and December 31, 2015. The recorded investment in loans excludes accrued interest receivable due to insignificance. Related allowances established generally pertain to those loans in which loan forbearance agreements were in the process of being negotiated or updated appraisals were pending, and the partial charge-off will be recorded when final information is received.

	Impaired Loans with a Specific Allowance			Impaired Loans with No Specific Allowance	
(Dollars in thousands)	Recorded Investment (Book Balance)	Unpaid Principal Balance (Legal Balance)	Related Allowance	Recorded Investment (Book Balance)	Unpaid Principal Balance (Legal Balance)
March 31, 2016					
Commercial real estate:					
Owner-occupied	$0	$ 0	$ 0	$ 2,029	$ 3,301
Non-owner occupied	0	0	0	7,686	8,521
Multi-family	0	0	0	225	381
Non-owner occupied residential	39	39	39	792	1,080
Acquisition and development:					
Commercial and land development	0	0	0	3	18
Commercial and industrial	0	0	0	714	768
Residential mortgage:					
First lien	1,357	1,392	103	3,423	4,133
Home equity - term	0	0	0	99	106
Home equity - lines of credit	0	0	0	567	712
Installment and other loans	7	8	7	9	35
	$1,403	$ 1,439	$ 149	$ 15,547	$ 19,055
December 31, 2015					
Commercial real estate:					
Owner-occupied	$0	$ 0	$ 0	$ 2,109	$ 3,344
Non-owner occupied	0	0	0	7,856	8,600
Multi-family	0	0	0	233	385
Non-owner occupied residential	0	0	0	895	1,211
Acquisition and development:					
Commercial and land development	0	0	0	5	19
Commercial and industrial	0	0	0	734	780
Residential mortgage:					
First lien	1,952	1,984	271	2,856	3,369
Home equity - term	0	0	0	103	110
Home equity - lines of credit	22	23	10	568	688
Installment and other loans	8	9	8	9	35
	$1,982	$ 2,016	$ 289	$ 15,368	$ 18,541

21

Table of Contents

The following tables summarize the average recorded investment in impaired loans and related interest income recognized on loans deemed impaired, generally on a cash basis, for the three months ended March 31, 2016 and 2015:

(Dollars in thousands)	2016 Average Impaired Balance	2016 Interest Income Recognized	2015 Average Impaired Balance	2015 Interest Income Recognized
Commercial real estate:				
Owner-occupied	$2,069	$ 0	$3,159	$ 0
Non-owner occupied	7,771	0	1,658	0
Multi-family	229	0	521	0
Non-owner occupied residential	875	0	1,303	0
Acquisition and development:				
Commercial and land development	4	0	392	2
Commercial and industrial	724	0	2,346	0
Residential mortgage:				
First lien	4,776	9	5,241	9
Home equity - term	101	0	93	0
Home equity - lines of credit	589	0	512	0
Installment and other loans	17	0	25	0
	$17,155	$ 9	$15,250	$ 11

The following table presents impaired loans that are TDRs, with the recorded investment as of March 31, 2016 and December 31, 2015.

(Dollars in thousands)	March 31, 2016 Number of Contracts	March 31, 2016 Recorded Investment	December 31, 2015 Number of Contracts	December 31, 2015 Recorded Investment
Accruing:				
Residential mortgage:				
First lien	9	$ 1,044	8	$ 793
	9	1,044	8	793
Nonaccruing:				
Residential mortgage:				
First lien	12	1,128	12	1,153
Installment and other loans	1	9	1	10
	13	1,137	13	1,163
	22	$ 2,181	21	$ 1,956

The loans presented above were considered TDRs as the result of the Company agreeing to below market interest rates for the risk of the transaction, allowing the loan to remain on interest-only status, or a reduction in interest rates, in order to give the borrowers an opportunity to improve their cash flows. For TDRs in default of their original terms, impairment is generally determined on a collateral-dependent approach, except for accruing residential mortgage TDRs, which are generally on the discounted cash flow approach.

Table of Contents

The following table presents the number of loans modified, and their pre-modification and post-modification investment balances for the three months ended March 31, 2016 and 2015:

(Dollars in thousands)	2016 Number of Contracts	2016 Pre-Modification Recorded Investment	2016 Post Modification Recorded Investment	2015 Number of Contracts	2015 Pre-Modification Recorded Investment	2015 Post Modification Recorded Investment
Three Months Ended March 31,						
Residential mortgage:						
First lien	1	$ 257	$ 0	1	$ 59	$ 59
	1	$ 257	$ 0	1	$ 59	$ 59

Certain loans modified during a period may no longer be outstanding at the end of the period if the loan was paid off. The following table presents restructured loans, included in nonaccrual loans, that were modified as TDRs within the previous 12 months and for which there was a payment default during the three months ended March 31, 2016 and 2015:

(Dollars in thousands)	2016 Number of Contracts	2016 Recorded Investment	2015 Number of Contracts	2015 Recorded Investment
Three Months Ended March 31,				
Residential mortgage:				
First lien	0	$ 0	5	$ 323
	0	$ 0	5	$ 323

No additional commitments have been made to borrowers whose loans are considered TDRs.

23

Table of Contents

Management further monitors the performance and credit quality of the loan portfolio by analyzing the average length of time a portfolio is past due, by aggregating loans based on its delinquencies. The following table presents the classes of the loan portfolio summarized by aging categories of performing loans and nonaccrual loans as of March 31, 2016 and December 31, 2015:

		Days Past Due					
(Dollars in thousands)	Current	30-59	60-89	90+ (still accruing)	Total Past Due	Non-Accrual	Total Loans
March 31, 2016							
Commercial real estate:							
Owner-occupied	$104,251	$184	$0	$ 0	$ 184	$2,029	$106,464
Non-owner occupied	146,986	59	0	0	59	7,686	154,731
Multi-family	37,439	0	0	0	0	225	37,664
Non-owner occupied residential	53,970	34	0	0	34	830	54,834
Acquisition and development:							
1-4 family residential construction	7,270	0	0	0	0	0	7,270
Commercial and land development	42,241	1	0	0	1	3	42,245
Commercial and industrial	76,563	0	0	0	0	714	77,277
Municipal	62,302	0	0	0	0	0	62,302
Residential mortgage:							
First lien	121,180	746	43	0	789	3,737	125,706
Home equity - term	16,478	0	0	1	1	99	16,578
Home equity - lines of credit	110,902	301	0	0	301	567	111,770
Installment and other loans	7,823	23	0	0	23	16	7,862
	$787,405	$1,348	$43	$ 1	$ 1,392	$15,906	$804,703
December 31, 2015							
Commercial real estate:							
Owner-occupied	$101,395	$74	$0	$ 0	$ 74	$2,109	$103,578
Non-owner occupied	137,545	0	0	0	0	7,856	145,401
Multi-family	34,876	0	0	0	0	233	35,109
Non-owner occupied residential	53,280	0	0	0	0	895	54,175
Acquisition and development:							
1-4 family residential construction	9,364	0	0	0	0	0	9,364
Commercial and land development	41,236	0	98	0	98	5	41,339
Commercial and industrial	72,846	24	21	0	45	734	73,625
Municipal	57,511	0	0	0	0	0	57,511
Residential mortgage:							
First lien	120,119	1,844	44	0	1,888	4,015	126,022
Home equity - term	17,200	34	0	0	34	103	17,337
Home equity - lines of credit	109,740	286	91	24	401	590	110,731
Installment and other loans	7,488	16	0	0	16	17	7,521
	$762,600	$2,278	$254	$ 24	$ 2,556	$16,557	$781,713

Table of Contents

The Company maintains the allowance for loan losses at a level believed to be adequate by management for probable incurred credit losses. The allowance is established and maintained through a provision for loan losses charged to earnings. Quarterly, management assesses the adequacy of the allowance for loan losses utilizing a defined methodology, which considers specific credit evaluation of impaired loans as discussed above, past loan loss historical experience, and qualitative factors. Management believes the approach properly addresses the requirements of ASC Subtopic 310-10-35 for loans individually identified as impaired, and ASC Subtopic 450-20 for loans collectively evaluated for impairment, and other bank regulatory guidance.

In connection with its quarterly evaluation of the adequacy of the allowance for loan losses, management continually reviews its methodology to determine if it continues to properly address the risk in the loan portfolio. For each loan class presented above, general allowances are provided for loans that are collectively evaluated for impairment, which is based on quantitative factors, principally historical loss trends for the respective loan class, adjusted for qualitative factors. In addition, an adjustment to the historical loss factors is made to account for delinquency and other potential risk not elsewhere defined within the Allowance for Loan and Lease Loss methodology.

Prior to December 31, 2015, the look back period for historical losses was 12 quarters, weighted one-half for the most recent four quarters, and one-quarter for each of the two previous four quarter periods in order to appropriately capture the loss history in the loan segment. Effective December 31, 2015, the Company extended the look back period to 16 quarters which will increase to 20 quarters through December 31, 2016. The extended period was on a prospective basis, more heavily weighted to the most recent four quarters. The look back period was extended as it was determined that a longer look back period is more consistent with the duration of an economic cycle. Management considers current economic, business, and real estate conditions, and the trends in historical charge-off percentages that resulted from applying partial charge-offs to impaired loans, and the impact of distressed loan sales during the year in determining the look back period.

In addition to the quantitative analysis, adjustments to the reserve requirements are allocated on loans collectively evaluated for impairment based on additional qualitative factors. As of March 31, 2016 and December 31, 2015, the qualitative factors used by management to adjust the historical loss percentage to the anticipated loss allocation, which may range from a minus 150 basis points to a positive 150 basis points per factor, include:

Nature and Volume of Loans – Loan growth in the current and subsequent quarters based on the Bank’s targeted growth and strategic plan, coupled with the types of loans booked based on risk management and credit culture, and the number of exceptions to loan policy, and supervisory loan to value exceptions, etc.

Concentrations of Credit and Changes within Credit Concentrations – Factors considered include the composition of the Bank’s overall portfolio and management’s evaluation related to concentration risk management and the inherent risk associated with the concentrations identified.

Underwriting Standards and Recovery Practices – Factors considered include changes to underwriting standards and perceived impact on anticipated losses, trends in the number of exceptions to loan policy; supervisory loan to value exceptions; and administration of loan recovery practices.

Delinquency Trends – Factors considered include the delinquency percentages noted in the portfolio relative to economic conditions, severity of the delinquencies, and whether the ratios are trending upwards or downwards.

Classified Loans Trends – Factors considered include the internal loan ratings of the portfolio, the severity of the ratings, and whether the loan segment’s ratings show a more favorable or less favorable trend, and underlying market conditions and their impact on the collateral values securing the loans.

Experience, Ability and Depth of Management/Lending staff – Factors considered include the years of experience of senior and middle management and the lending staff and turnover of the staff, and instances of repeat criticisms of ratings.

Quality of Loan Review – Factors include the years of experience of the loan review staff, in-house versus outsourced provider of review, turnover of staff and the perceived quality of their work in relation to other external information.

National and Local Economic Conditions – Ratios and factors considered include trends in the consumer price index (CPI), unemployment rates, housing price index, housing statistics compared to the prior year, bankruptcy rates, regulatory and legal environment risks and competition

25

Table of Contents

Activity in the allowance for loan losses for the three months ended March 31, 2016 and 2015 was as follows:

	Commercial					Consumer				
(Dollars in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Residential Mortgage	Installment and Other	Total	Unallocated	Total
March 31, 2016										
Balance, beginning of period	$7,883	$ 850	$ 1,012	$ 58	$9,803	$2,870	$ 121	$2,991	$ 774	$13,568
Provision for loan losses	33	(111)	37	4	(37)	45	102	147	(110)	0
Charge-offs	0	0	(21)	0	(21)	(244)	(64)	(308)	0	(329)
Recoveries	80	0	2	0	82	6	20	26	0	108
Balance, end of period	$7,996	$ 739	$ 1,030	$ 62	$9,827	$2,677	$ 179	$2,856	$ 664	$13,347
March 31, 2015										
Balance, beginning of period	$9,462	$ 697	$ 806	$ 183	$11,148	$2,262	$ 119	$2,381	$ 1,218	$14,747
Provision for loan losses	(63)	(87)	(137)	(62)	(349)	494	15	509	(160)	0
Charge-offs	(66)	(22)	(26)	0	(114)	(201)	(20)	(221)	0	(335)
Recoveries	13	0	22	0	35	12	2	14	0	49
Balance, end of period	$9,346	$ 588	$ 665	$ 121	$10,720	$2,567	$ 116	$2,683	$ 1,058	$14,461

The following table summarizes the ending loan balances individually evaluated for impairment based upon loan segment, as well as the related allowance for loan losses allocation for each at March 31, 2016 and December 31, 2015:

	Commercial					Consumer				
(Dollars in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Residential Mortgage	Installment and Other	Total	Unallocated	Total
March 31, 2016										
Loans allocated by:										
Individually evaluated for impairment	$10,771	$3	$714	$0	$11,488	$5,446	$16	$5,462	$0	$16,950
Collectively evaluated for impairment	342,922	49,512	76,563	62,302	531,299	248,608	7,846	256,454	0	787,753
	$353,693	$49,515	$77,277	$62,302	$542,787	$254,054	$7,862	$261,916	$0	$804,703
Allowance for loan losses allocated by:										
Individually evaluated for impairment	$39	$0	$0	$0	$39	$103	$7	$110	$0	$149
Collectively evaluated for impairment	7,957	739	1,030	62	9,788	2,574	172	2,746	664	13,198
	$7,996	$739	$1,030	$62	$9,827	$2,677	$179	$2,856	$664	$13,347
December 31, 2015										
Loans allocated by:										
Individually evaluated for impairment	$11,093	$5	$734	$0	$11,832	$5,501	$17	$5,518	$0	$17,350
Collectively evaluated for impairment	327,170	50,698	72,891	57,511	508,270	248,589	7,504	256,093	0	764,363
	$338,263	$50,703	$73,625	$57,511	$520,102	$254,090	$7,521	$261,611	$0	$781,713

Allowance for loan losses allocated by:										
Individually evaluated for impairment	$0	$0	$0	$0	$0	$281	$8	$289	$0	$289
Collectively evaluated for impairment	7,883	850	1,012	58	9,803	2,589	113	2,702	774	13,279
	$7,883	$850	$1,012	$58	$9,803	$2,870	$121	$2,991	$774	$13,568

Table of Contents

NOTE 4. INCOME TAXES

The Company files income tax returns in the U.S. federal jurisdiction and the Commonwealth of Pennsylvania. The Bank also files an income tax return in the State of Maryland. The Company is no longer subject to U.S. federal, state or local income tax examination by tax authorities for years before 2012.

The components of income tax expense for the three months ended March 31, 2016 and 2015 are summarized as follows:

(Dollars in thousands)	Three months ended March 31, 2016	2015
Current year provision (benefit):		
Federal	$(112)	$(15)
State	(2)	4
	(114)	(11)
Deferred tax expense		
Federal	722	720
State	6	6
	728	726
Net income tax expense	$614	$715

The provision for income taxes includes $497,000 and $535,000 of applicable income tax expense related to net securities gains for the three months ended March 31, 2016 and 2015.

The components of the net deferred tax asset, included in other assets, are as follows:

(Dollars in thousands)	March 31, 2016	December 31, 2015
Deferred tax assets:		
Allowance for loan losses	$ 5,078	$ 5,111
Deferred compensation	546	547
Retirement plans and salary continuation	1,865	1,824
Share-based compensation	417	343
Off balance sheet reserves	224	218
Nonaccrual loan interest	315	246
Goodwill	116	124
Bonus accrual	69	359
Low income housing credit carryforward	1,735	1,652
Alternative minimum tax credit carryforward	2,262	2,195
Charitable contribution carryforward	69	211
Net operating loss carryforward	3,798	4,431
Other	190	182
Total deferred tax assets	16,684	17,443
Deferred tax liabilities:		
Depreciation	771	815
Net unrealized gains on securities available for sale	2,387	646
Mortgage servicing rights	699	669
Purchase accounting adjustments	336	352
Other	180	181
Total deferred tax liabilities	4,373	2,663
Net deferred tax asset	$ 12,311	$ 14,780

The provision for income taxes differs from that computed by applying statutory rates to income before income taxes primarily due to the effects of tax-exempt income, non-deductible expenses and tax credits.

Table of Contents

As of March 31, 2016, the Company had charitable contribution, low-income housing, and net operating loss carryforwards that expire through 2019, 2036 and 2032, respectively.

In assessing whether or not some or all of our deferred tax asset is more likely than not to be realized in the future, management considers all positive and negative evidence, including projected future taxable income, tax planning strategies and recent financial operating results. The ultimate realization of deferred tax assets is dependent upon existence, or generation, of taxable income in the periods when those temporary differences and net operating loss and credit carryforwards are deductible. Management considered projected future taxable income, length of time needed for carryforwards to reverse, available tax planning strategies, and other factors in making its assessment that it was more likely than not the net deferred tax assets would be realized, and that no valuation allowance was required at March 31, 2016 or December 31, 2015.

NOTE 5. SHARE-BASED COMPENSATION PLANS

The Company maintains share-based compensation plans, the purpose of which are to provide officers, employees, and non-employee members of the Board of Directors of the Company and the Bank, with additional incentive to further the success of the Company. In May 2011, the shareholders of the Company approved the 2011 Orrstown Financial Services, Inc. Incentive Stock Plan (the "Plan"). Under the Plan, 381,920 shares of the common stock of the Company were reserved to be issued. As of March 31, 2016, 151,445 shares were available to be issued under the Plan.

Incentive awards under the Plan may consist of grants of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, deferred stock units and performance shares. All employees of the Company and its present or future subsidiaries, and members of the Board of Directors of the Company or any subsidiary of the Company, are eligible to participate in the Plan. The Plan allows for the Compensation Committee of the Board of Directors to determine the type of incentive to be awarded, its term, manner of exercise, vesting of awards and restrictions on shares. Generally, awards are nonqualified under the IRS code, unless the awards are deemed to be incentive awards to employees, at the Compensation Committee's discretion.

A roll forward of the Company's nonvested restricted shares for the three months ended March 31, 2016 is presented below:

	Shares	Weighted Average Grant Date Fair Value
Nonvested shares, beginning of year	197,381	$ 16.17
Granted	29,045	17.69
Forfeited	(1,083)	17.26
Vested	(2,500)	10.43
Nonvested shares, at period end	222,843	$ 16.43

For the three months ended March 31, 2016 and 2015, $237,000 and $131,000 was recognized as expense on the restricted stock awards, with tax benefits recorded of $83,000 and $46,000 for the respective periods. As of March 31, 2016 and December 31, 2015, the unrecognized compensation expense related to the stock awards were $2,495,000 and $2,293,000. The unrecognized compensation expense is expected to be recognized over a weighted-average period of 3.0 years.

A roll forward of the Company's outstanding stock options for the three months ended March 31, 2016 is presented below:

	Shares	Weighted Average Exercise Price

Outstanding at beginning of year	101,460	$ 28.72
Forfeited	(2,050)	26.54
Options outstanding and exercisable, at period end	99,410	$ 28.76

Table of Contents

The exercise price of each option equals the market price of the Company's stock on the date of grant and an option's maximum term is ten years. All options are fully vested upon issuance. Information pertaining to options outstanding and exercisable at March 31, 2016 is as follows:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
$21.14 - $24.99	35,674	4.15	$ 21.47
$25.00 - $29.99	2,792	4.01	25.76
$30.00 - $34.99	38,640	1.53	31.28
$35.00 - $37.59	22,304	1.25	36.44
$21.14 - $37.59	99,410	2.48	$ 28.76

The options outstanding and exercisable had no intrinsic value at March 31, 2016 and December 31, 2015 as each exercise price exceeded the market value.

The Company also maintains an employee stock purchase plan, in order to provide employees of the Company and its subsidiaries an opportunity to purchase stock of the Company. Under the employee stock purchase plan, eligible employees may purchase shares in an amount that does not exceed 10% of their annual salary, up to the IRS limit, at the lower of 95% of the fair market value of the shares on the semi-annual offering date, or related purchase date. The Company reserved 350,000 shares of its common stock, after making adjustments for stock dividends and a stock split, to be issued under the employee stock purchase plan. As of March 31, 2016, 189,877 shares were available to be issued under the employee stock purchase plan. Employees purchased 2,461 and 2,964 shares at a weighted average price of $16.57 and $15.74 for the three months ended March 31, 2016 and 2015. Compensation expense recognized on the employee stock purchase plan totaled $3,000 and $3,000 for the three months ended March 31, 2016 and 2015.

The Company uses a combination of issuing new shares or treasury shares to meet stock compensation exercises depending on market conditions.

NOTE 6. SHAREHOLDERS' EQUITY AND REGULATORY CAPITAL

On January 19, 2016, the Company filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission (the "Commission") that provides for up to an aggregate of $100,000,000, through the sale of common stock, preferred stock, warrants, debt securities, and units. To date, the Company has not issued any securities under this shelf registration.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Although applicable to the Bank, prompt corrective action provisions are not applicable to bank holding companies, including financial holding companies.

Quantitative measures established by regulators to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (as set forth in the following table) of total and Tier 1 capital (as defined in regulations) to risk-weighted assets (as defined), common equity Tier 1 capital (as defined) to risk weighted assets, and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of March 31, 2016 and December 31, 2015, the Company and the Bank meet all capital adequacy requirements to which they are subject.

Effective January 1, 2015, the Company and Bank became subject to final rules establishing a new comprehensive capital framework for U.S. banking organizations, including community banks (the "Basel III Capital Rules"), which substantially

29

Table of Contents

revised the risk-based capital requirements in comparison to the previously existing U.S. risk-based capital rules. The Basel III Capital Rules, among other things, (i) introduced a new capital measure called "Common Equity Tier 1" ("CET1"), (ii) increased the minimum requirements for Tier 1 Capital ratio as well as the minimum levels to be considered well capitalized under prompt corrective action; (iii) and introduced the "capital conservation buffer", designed to absorb losses during periods of economic stress. Institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer are subject to constraints on dividends, equity repurchases and discretionary bonuses to executive officers based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

As of March 31, 2016, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Company and the Bank's actual capital ratios as of March 31, 2016 and December 31, 2015, are also presented in the table.

	Actual		Minimum Capital Requirement		Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2016						
Total capital to risk weighted assets						
Orrstown Financial Services, Inc.	$137,389	15.7%	$ 70,181	8.0 %	n/a	n/a
Orrstown Bank	121,703	13.9%	70,133	8.0 %	$ 87,666	10.0 %
Tier 1 capital to risk weighted assets						
Orrstown Financial Services, Inc.	126,352	14.4%	52,636	6.0 %	n/a	n/a
Orrstown Bank	110,673	12.6%	52,599	6.0 %	70,133	8.0 %
CET1 to risk weighted assets						
Orrstown Financial Services, Inc.	126,352	14.4%	39,477	4.5 %	n/a	n/a
Orrstown Bank	110,673	12.6%	39,450	4.5 %	56,983	6.5 %
Tier 1 capital to average assets						
Orrstown Financial Services, Inc.	126,352	9.8 %	51,579	4.0 %	n/a	n/a
Orrstown Bank	110,673	8.6 %	51,609	4.0 %	64,511	5.0 %
December 31, 2015						
Total capital to risk weighted assets						
Orrstown Financial Services, Inc.	$134,562	15.8%	$ 68,078	8.0 %	n/a	n/a
Orrstown Bank	118,671	14.0%	68,027	8.0 %	$ 85,034	10.0 %
Tier 1 capital to risk weighted assets						
Orrstown Financial Services, Inc.	123,825	14.6%	51,058	6.0 %	n/a	n/a
Orrstown Bank	107,942	12.7%	51,021	6.0 %	68,027	8.0 %
CET1 to risk weighted assets						
Orrstown Financial Services, Inc.	123,825	14.6%	38,294	4.5 %	n/a	n/a
Orrstown Bank	107,942	12.7%	38,265	4.5 %	55,272	6.5 %
Tier 1 capital to average assets						
Orrstown Financial Services, Inc.	123,825	9.8 %	50,684	4.0 %	n/a	n/a
Orrstown Bank	107,942	8.5 %	50,695	4.0 %	63,368	5.0 %

On September 14, 2015, the Board of Directors of the Company authorized a stock repurchase program under which the Company may repurchase up to 5% of the Company's outstanding shares of common stock, or approximately

416,000 shares,

30

Table of Contents

in the open market, in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended. The extent to which the Company repurchases its shares, and the timing of such repurchases, will depend upon a variety of factors, including market conditions, regulatory requirements and other corporate considerations, as determined by management. Purchases may be made from time to time on open market or privately negotiated transactions. The repurchase program may be suspended or discontinued at any time. As of March 31, 2016, 61,298 shares had been repurchased under the program at a total cost of $1,051,000, or $17.15 per share.

NOTE 7. EARNINGS PER SHARE

Earnings per share for the three months ended March 31, 2016 and 2015 were as follows:

	Three Months Ended March 31,	
(Dollars in thousands, except per share data)	2016	2015
Net income	$2,580	$2,462
Weighted average shares outstanding (basic)	8,071	8,110
Impact of common stock equivalents	68	24
Weighted average shares outstanding (diluted)	8,139	8,134
Per share information:		
Basic earnings per share	$0.32	$0.30
Diluted earnings per share	0.32	0.30

Stock options amounting to 99,000 and 130,000 shares of common stock were not considered in computing diluted earnings per share for the three months ended March 31, 2016 and 2015 as their exercise would have been antidilutive as the exercise price exceeded the average market value.

NOTE 8. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

	Contract or Notional Amount	
(Dollars in thousands)	March 31, 2016	December 31, 2015
Commitments to fund:		
Revolving, open ended home equity loans	$ 115,813	$ 110,473
1-4 family residential construction loans	5,464	6,153
Commercial real estate, construction and land development loans	41,065	14,174
Commercial, industrial and other loans	87,971	84,480
Standby letters of credit	7,002	6,510

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit-worthiness on a

Table of Contents

case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, equipment, residential real estate, and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Company holds collateral supporting those commitments when deemed necessary by management. The current amount of liability, as of March 31, 2016 and December 31, 2015, for guarantees under standby letters of credit issued was not material.

The Company currently maintains a reserve in other liabilities totaling $519,000 and $472,000 at March 31, 2016 and December 31, 2015 for off-balance sheet credit exposures that currently are not funded, based on historical loss experience of the related loan class. For the three months ended March 31, 2016 and 2015, the amount expensed (recovered) was $47,000 and $(68,000).

The Company has sold loans to the Federal Home Loan Bank of Chicago as part of its Mortgage Partnership Finance Program ("MPF Program"). Under the terms of the MPF Program, there is limited recourse back to the Company for loans that do not perform in accordance with the terms of the loan agreement. Each loan that is sold under the program is "credit enhanced" such that the individual loan's rating is raised to "AA," as determined by the Federal Home Loan Bank of Chicago. The sum of total loans sold under the MPF Program with limited recourse was $42,478,000 and $44,124,000 at March 31, 2016 and December 31, 2015, with limited recourse back to the Company on these loans of $8,199,000 and $8,230,000 at these dates. Many of the loans sold under the MPF Program have primary mortgage insurance, which reduces the Company's overall exposure. The Company is in the process of foreclosing on loans sold under the MPF Program or recovering amounts previously charged off, with a resulting net charge (recovery) of $(52,000) and $40,000 for the three months ended March 31, 2016 and 2015. These amounts, charged to other expenses represent an estimate of the Company's loss under its recourse exposure.

NOTE 9. FAIR VALUE DISCLOSURES

The Company meets the requirements for disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments and all non-financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Fair value measurements under GAAP describes a framework for measuring fair value and requires disclosures about fair value measurements by establishing a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to valuation techniques that employ unobservable inputs (Level 3). If the inputs used to measure the assets or liabilities fall within different levels of the hierarchy, the classification is based on the lowest level input that is significant to the fair value measurement of the asset or liability. Classification of assets and liabilities within the hierarchy considers the markets in which the assets and liabilities are traded and the reliability and transparency of the assumptions used to determine fair value.

The three levels are defined as follows: Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active or by model-based techniques in which all significant inputs are observable in the market for the asset or liability, for substantially the full term of the financial instrument. Level 3 – the valuation methodology is derived from model-based techniques in which at least one significant input is unobservable to the fair value measurement and based on the Company's own assumptions about market participants' assumptions.

Following is a description of the valuation methodologies used for instruments measured on a recurring basis at estimated fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Table of Contents

Securities

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, securities are classified within Level 2 and fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. All of the Company's securities are classified as available for sale.

The Company had no fair value liabilities measured on a recurring basis at March 31, 2016 and December 31, 2015. A summary of assets at March 31, 2016 and December 31, 2015, measured at estimated fair value on a recurring basis was as follows:

(Dollars in Thousands)	Level 1	Level 2	Level 3	Total Fair Value Measurements
March 31, 2016				
Securities available for sale:				
U.S. Government Agencies	$ 0	$45,139	$ 0	$ 45,139
States and political subdivisions	0	129,181	0	129,181
U.S. Government Sponsored enterprises (GSE) residential mortgage-backed securities	0	130,775	0	130,775
GSE residential collateralized mortgage obligations (CMOs)	0	14,404	0	14,404
Private label CMOs	0	8,018	0	8,018
Total debt securities	0	327,517	0	327,517
Equity securities - financial services	0	73	0	73
Total securities	$ 0	$327,590	$ 0	$ 327,590
December 31, 2015				
Securities available for sale:				
U.S. Government Agencies	$ 0	$47,227	$ 0	$ 47,227
States and political subdivisions	0	125,961	0	125,961
GSE residential mortgage-backed securities	0	132,349	0	132,349
GSE residential collateralized mortgage obligations (CMOs)	0	15,843	0	15,843
GSE commercial CMOs	0	63,770	0	63,770
Private label CMOs	0	8,901	0	8,901
Total debt securities	0	394,051	0	394,051
Equity securities - financial services	0	73	0	73
Total securities	$ 0	$394,124	$ 0	$ 394,124

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

Table of Contents

Impaired Loans

The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral, or discounted cash flows based on a market rate of interest for performing TDRs. For collateral dependent loans, fair value is measured based on the value of the collateral securing the loan, less estimated costs to sell. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The value of the real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction, or if management adjusts the appraisal value, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal, if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). For discounted cash flow impairment measurement on residential mortgage loans, the Company discounts cash flows on a particular credit, utilizing a market rate of interest that adequately reflects the terms and conditions of the note, and the credit risk associated with it. Impaired loans with an allocation to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the consolidated statements of income. Specific allocations to the allowance for loan losses or partial charge-offs were $2,234,000 and $2,246,000 at March 31, 2016 and December 31, 2015. Changes in the fair value of impaired loans for those still held at March 31, considered in the determination as to the provision for loan losses, totaled $(5,000) and $862,000 for the three months ended March 31, 2016 and 2015.

Foreclosed Real Estate

Other real estate property acquired through foreclosure is initially recorded at the fair value of the property at the transfer date less estimated selling cost. Subsequently, other real estate owned is carried at the lower of its carrying value or the fair value less estimated selling cost. Fair value is usually determined based upon an independent third-party appraisal of the property or occasionally upon a recent sales offer. Specific charges to value the real estate owned at the lower of cost or fair value on properties held at March 31, 2016 and December 31, 2015 were $168,000 and $129,000. Changes in the fair value of foreclosed real estate for those still held at March 31, charged to real estate expenses, totaled $51,000 and $0 for the three months ended March 31, 2016 and 2015.

The following table presents additional qualitative information about assets measured on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

(Dollars in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range
March 31, 2016				
Impaired loans	$ 4,850	Appraisal of collateral	Management adjustments on appraisals for property type and recent activity	0% - 60% discount
			Management adjustments for liquidation expenses	6% - 44% discount
Foreclosed real estate	265	Appraisal of collateral	Management adjustments on appraisals for property type and recent activity	10% - 20% discount
			Management adjustments for liquidation expenses	5% - 6% discount
December 31, 2015				
Impaired loans	$ 4,757	Appraisal of collateral	Management adjustments on appraisals for property type and recent activity	0% - 70% discount
			Management adjustments for liquidation expenses	6% - 44% discount
Foreclosed real estate	175	Appraisal of collateral	Management adjustments on appraisals for property type and recent activity	10% - 20% discount
			Management adjustments for liquidation expenses	5% - 6% discount

Table of Contents

A summary of assets at March 31, 2016 and December 31, 2015, measured at estimated fair value on a nonrecurring basis was as follows:

(Dollars in thousands)	Level 1	Level 2	Level 3	Total Fair Value Measurements
March 31, 2016				
Impaired Loans				
Commercial real estate:				
Owner-occupied	$ 0	$ 0	$836	$ 836
Non-owner occupied	0	0	736	736
Multi-family	0	0	225	225
Non-owner occupied residential	0	0	507	507
Acquisition and development:				
Commercial and land development	0	0	3	3
Residential mortgage:				
First lien	0	0	2,340	2,340
Home equity - lines of credit	0	0	194	194
Installment and other loans	0	0	9	9
Impaired loans, net	$ 0	$ 0	$4,850	$ 4,850
Foreclosed real estate				
Residential	$ 0	$ 0	$186	$ 186
Commercial and land development	0	0	79	79
Total foreclosed real estate	$ 0	$ 0	$265	$ 265
December 31, 2015				
Impaired Loans				
Commercial real estate:				
Owner-occupied	$ 0	$ 0	$881	$ 881
Non-owner occupied	0	0	736	736
Multi-family	0	0	233	233
Non-owner occupied residential	0	0	570	570
Acquisition and development:				
Commercial and land development	0	0	5	5
Residential mortgage:				
First lien	0	0	2,094	2,094
Home equity - lines of credit	0	0	229	229
Installment and other loans	0	0	9	9
Impaired loans, net	$ 0	$ 0	$4,757	$ 4,757
Foreclosed real estate				
Residential	$ 0	$ 0	$101	$ 101
Commercial and land development	0	0	74	74
Total foreclosed real estate	$ 0	$ 0	$175	$ 175

Table of Contents

Fair values of financial instruments

In addition to those disclosed above, the following methods and assumptions were used by the Company in estimating fair values of financial instruments as disclosed herein:

Cash and Due from Banks and Interest Bearing Deposits with Banks

The carrying amounts of cash and due from banks and interest bearing deposits with banks approximate their fair value.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. These loans typically consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale.

Loans Receivable

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered in the market for loans with similar terms to borrowers of similar credit quality.

Restricted Investment in Bank Stock

These investments are carried at cost. The Company is required to maintain minimum investment balances in these stocks, which are not actively traded and therefore have no readily determinable market value.

Deposits

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposits and IRAs are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market to a schedule of aggregated expected maturities on time deposits.

Short-Term Borrowings

The carrying amounts of federal funds purchased, borrowings under Repurchase Agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analysis based on the Company’s current borrowing rates for similar types of borrowing arrangements.

Long-Term Debt

The fair value of the Company’s fixed rate long-term borrowings is estimated using a discounted cash flow analysis based on the Company’s current incremental borrowing rate for similar types of borrowing arrangements. The carrying amounts of variable-rate long-term borrowings approximate their fair values at the reporting date.

Accrued Interest

The carrying amounts of accrued interest receivable and payable approximate their fair values.

Off-Balance-Sheet Instruments

The Company generally does not charge commitment fees. Fees for standby letters of credit and other off-balance-sheet instruments are not significant.

Table of Contents

The estimated fair values of the Company's financial instruments were as follows at March 31, 2016 and December 31, 2015:

(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
March 31, 2016					
Financial Assets					
Cash and due from banks	$ 12,281	$ 12,281	$12,281	$ 0	$ 0
Interest bearing deposits with banks	54,634	54,634	54,634	0	0
Restricted investments in bank stocks	6,270	n/a	n/a	n/a	n/a
Securities available for sale	327,590	327,590	0	327,590	0
Loans held for sale	3,499	3,595	0	3,595	0
Loans, net of allowance for loan losses	791,356	810,260	0	0	810,260
Accrued interest receivable	3,582	3,582	0	1,709	1,873
Financial Liabilities					
Deposits	1,048,376	1,055,702	0	1,055,702	0
Short-term borrowings	62,693	62,693	0	62,693	0
Long-term debt	24,413	25,259	0	25,259	0
Accrued interest payable	376	376	0	376	0
Off-balance sheet instruments	0	0	0	0	0
December 31, 2015					
Financial Assets					
Cash and due from banks	$ 11,412	$ 11,412	$11,412	$ 0	$ 0
Interest bearing deposits with banks	16,928	16,928	16,928	0	0
Restricted investments in bank stocks	8,720	n/a	n/a	n/a	n/a
Securities available for sale	394,124	394,124	0	394,124	0
Loans held for sale	5,917	6,045	0	6,045	0
Loans, net of allowance for loan losses	768,145	776,067	0	0	776,067
Accrued interest receivable	3,845	3,845	0	2,257	1,588
Financial Liabilities					
Deposits	1,032,167	1,032,265	0	1,032,265	0
Short-term borrowings	89,156	89,156	0	89,156	0
Long-term debt	24,495	25,357	0	25,357	0
Accrued interest payable	366	366	0	366	0
Off-balance sheet instruments	0	0	0	0	0

Table of Contents

NOTE 10. CONTINGENCIES

The nature of the Company's business generates a certain amount of litigation involving matters arising out of the ordinary course of business. Except as described below, in the opinion of management, there are no legal proceedings that might have a material effect on the results of operations, liquidity, or the financial position of the Company at this time.

The Company, the Bank and certain current and former directors and executive officers (collectively, "Orrstown Defendants") are defendants in a putative class action filed by Southeastern Pennsylvania Transportation Authority ("SEPTA") on May 25, 2012, in the United States District Court for the Middle District of Pennsylvania. In a later amended complaint, the list of defendants was expanded to include the Company's independent registered public accounting firm and the underwriters of the Company's March 2010 public offering of common stock. The complaint, as amended, alleges among other things that (i) in connection with the Company's Registration Statement on Form S-3 dated February 23, 2010 and its Prospectus Supplement dated March 23, 2010, and (ii) during the purported class period of March 15, 2010 through April 5, 2012, the Company issued materially false and misleading statements regarding the Company's lending practices and financial results, including misleading statements concerning the stringent nature of the Bank's credit practices and underwriting standards, the quality of its loan portfolio, and the intended use of the proceeds from the Company's March 2010 public offering of common stock. The complaint asserts claims under Sections 11, 12(a) and 15 of the Securities Act of 1933, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and seeks class certification, unspecified money damages, interest, costs, fees and equitable or injunctive relief.

On June 22, 2015, the Court dismissed without prejudice SEPTA's amended complaint against all defendants, finding that SEPTA failed to state a claim under either the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended. The Court ordered that, within 30 days, SEPTA either seek leave to amend its amended complaint, accompanied by the proposed amendment, or file a notice of its intention to stand on the amended complaint.

On July 22, 2015, SEPTA filed a motion for leave to amend under Local Rule 15.1, as allowed by the Court's ruling on June 22, 2015. Many of the allegations of the proposed second amended complaint are essentially the same or similar to the allegations of the dismissed amended complaint. The proposed second amended complaint also alleges that the Orrstown Defendants did not publicly disclose certain alleged failures of internal controls over loan underwriting, risk management, and financial reporting during the period 2009 to 2012, in violation of the federal securities laws. On February 8, 2016, the Court granted SEPTA's motion for leave to amend and SEPTA filed its second amended complaint that same day.

On February 25, 2016, the Court issued a scheduling Order directing: all defendants to file any motions to dismiss by March 18, 2016; SEPTA to file an omnibus opposition to defendants' motions to dismiss by April 8, 2016; and all defendants to file reply briefs in support of their motions to dismiss by April 22, 2016. Defendants timely filed their motions to dismiss the second amended complaint and the parties filed their briefs in accordance with the Court-ordered schedule. The February 25, 2016 Order stays all discovery and other deadlines in the case (including the filing of SEPTA's motion for class certification) pending the outcome of the motions to dismiss.

The Company believes that the allegations of SEPTA's second amended complaint are without merit and intends to vigorously defend itself against those claims.

Given the litigation is still in the pleading stage, it is not possible at this time to estimate reasonably possible losses, or even a range of reasonably possible losses, in connection with the litigation.

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

Overview

The Company, headquartered in Shippensburg, Pennsylvania, is a one bank holding company that has elected status as a financial holding company. The consolidated financial information presented herein reflects the Company and its wholly-owned subsidiary, Orrstown Bank. At March 31, 2016, the Company had total assets of $1,287,279,000, total liabilities of $1,149,032,000 and total shareholders' equity of $138,247,000.

The U.S. economy is in its seventh year of recovery from one of its longest and most severe economic recessions in recent history. The strength of the recovery has been modest by historical standards, with GDP growth struggling to sustain momentum above 2.0%. Unemployment continues to decline, however it remains to be seen if this will continue. Corporate profitability for publicly traded companies has been declining for a few quarters and historically this has led to cutbacks in business investment and employment. In addition, most of the rest of the world's economies appear to be in a recession or experiencing decelerating growth which has resulted in volatile markets. Although the dollar strengthened significantly in 2014 and 2015, the dollar weakened somewhat in the first quarter of 2016. This has led to a mild increase in commodity prices. The Federal Reserve paused their plans to tighten monetary policy due to the increased uncertainty.

Caution About Forward Looking Statements

Certain statements appearing herein which are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, the Company may make other written and oral communications, from time to time, that contain such statements. Such forward-looking statements refer to a future period or periods, reflecting management's current beliefs as to likely future developments, and use words like "may," "will," "expect," "estimate," "anticipate" or similar terms. Forward-looking statements are statements that include projections, predictions, expectations, or beliefs about events or results or otherwise are not statements of historical facts, including, but not limited to, statements related to new business development, new loan opportunities, growth in the balance sheet and fee based revenue lines of business, reducing risk assets, and mitigating losses in the future. Actual results and trends could differ materially from those set forth in such statements and there can be no assurances that we will achieve the desired level of new business development and new loans, growth in the balance sheet and fee based revenue lines of business, continue to reduce risk assets or mitigate losses in the future. Factors that could cause actual results to differ from those expressed or implied by the forward-looking statements include, but are not limited to, the following: ineffectiveness of the Company's business strategy due to changes in current or future market conditions; the effects of competition, including industry consolidation and development of competing financial products and services; changes in laws and regulations, including the Dodd-Frank Wall Street Reform and Consumer Protection Act; interest rate movements; changes in credit quality; inability to raise capital under favorable conditions, volatilities in the securities markets; deteriorating economic conditions; and other risks and uncertainties, including those detailed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015, and this Quarterly Report on Form 10-Q under the sections titled "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in other filings made with the Commission. The statements are valid only as of the date hereof and the Company disclaims any obligation to update this information.

The following is a discussion of our consolidated financial condition at March 31, 2016 and results of operations for the three months ended March 31, 2016 and 2015. Throughout this discussion, the yield on earning assets is stated on a fully taxable-equivalent basis and balances represent average daily balances unless otherwise stated. The discussion and analysis should be read in conjunction with our Consolidated Financial Statements (Unaudited) and Notes thereto presented elsewhere in this report. Certain prior period amounts, presented in this discussion and analysis, have been reclassified to conform to current period classifications.

Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with GAAP and follow general practices within the financial services industry in which it operates. Management, in order to prepare the Company's consolidated financial statements, is required to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the balance sheet date through the date the financial statements are filed with the Commission. As this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, the Company has identified the adequacy of the allowance for loan losses and accounting for income taxes as critical accounting policies.

The allowance for loan losses represents management's estimate of probable incurred credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on

39

impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheet.

The Company recognizes deferred tax assets and liabilities for the future effects of temporary differences and tax credits. Enacted tax rates are applied to cumulative temporary differences based on expected taxable income in the periods in which the deferred tax asset or liability is anticipated to be realized. Future tax rate changes could occur that would require the recognition of income or expense in the statement of operations in the period in which they are enacted. Deferred tax assets must be reduced by a valuation allowance if in management's judgment it is "more likely than not" that some portion of the asset will not be realized. Management may need to modify its judgment in this regard, from one period to another, should a material change occur in the business environment, tax legislation, or in any other business factor that could impair the Company's ability to benefit from the asset in the future. Management considered projected future taxable income, length of time needed for carryforwards to reverse, available tax planning strategies, and other factors in making its assessment that it was more likely than not the net deferred taxes would be realized.

Readers of the consolidated financial statements should be aware that the estimates and assumptions used in the Company's current financial statements may need to be updated in future financial presentations for changes in circumstances, business or economic conditions in order to fairly represent the condition of the Company at that time.

RESULTS OF OPERATIONS

QUARTER ENDED MARCH 31, 2016 COMPARED TO QUARTER ENDED MARCH 31, 2015

Summary

The Company recorded net income of $2,580,000 for the three months ended March 31, 2016 compared to net income of $2,462,000 for the same period in 2015. Diluted EPS for the three months ended March 31, 2016 were $0.32, compared to $0.30 for the three months ended March 31, 2015. Net interest income of $8,650,000 was $335,000 higher for the three months ended March 31, 2016 than in the same period of 2015. This improvement occurred as average loans increased by $82,455,000 between the two periods with average loans outstanding totaling $795,785,000 for the three months ended March 31, 2016, an 11.6% increase as compared to the same period in 2015.

Net Interest Income

Net interest income, which is the difference between interest income and fees on interest-earning assets and interest expense on interest-bearing liabilities, is the primary component of the Company's revenue. Interest-earning assets include loans, securities and federal funds sold. Interest bearing liabilities include deposits and borrowed funds. To compare the tax-exempt yields to taxable yields, amounts are adjusted to pretax equivalents based on a 35% federal corporate tax rate.

Net interest income is affected by changes in interest rates, volumes of interest-earning assets and interest-bearing liabilities and the composition of those assets and liabilities. The "net interest spread" and "net interest margin" are two common statistics related to changes in net interest income. The net interest spread represents the difference between the yields earned on interest-earning assets and the rates paid for interest-bearing liabilities. The net interest margin is defined as the ratio of net interest income to average earning assets. Through the use of non-interest bearing demand deposits and shareholders' equity, the net interest margin exceeds the net interest spread, as these funding sources are non-interest bearing.

For the three months ended March 31, 2016, net interest income measured on a fully tax equivalent basis increased $538,000 to $9,157,000 from $8,619,000 in the corresponding period in 2015. The primary reason for the increase in net interest income was a 9.4% increase in interest earning assets, offset partially by a higher average in interest bearing liabilities and higher cost of funds on them.

Interest income earned on loans increased $660,000 from $7,601,000 for the quarter ended March 31, 2015 to $8,261,000 for the same period in 2016. The primary reason for the increase was growth in the average loan balance from $713,330,000 for the three months ended March 31, 2015 to $795,785,000 for the same period in 2016, offset partially by a 14 basis point decrease in yield on the loans. Loan yields declined despite a 25 basis point increase in short-term rates in the fourth quarter of 2015 due to proceeds received from loan paydowns and payoffs being reinvested in lower interest rates due to competitive market conditions.

Securities interest income increased $237,000 to $2,142,000 for the three months ended March 31, 2016, from $1,905,000 for the same period in 2015. The average balance on securities has increased from $356,635,000 for the three months ended

Table of Contents

March 31, 2015 to $363,614,000 for the same period in 2016. The increase in interest income on securities was also positively affected by higher tax equivalent yields earned, which averaged 2.37% in 2016 compared to 2.17% for the same period in 2015. The increase in short-term interest rates in the fourth quarter of 2015 favorably impacted yields earned 2016.

Interest expense on deposits and borrowings for the three months ended March 31, 2016 was $1,311,000, an increase of $398,000, from $913,000 in the same period in 2015. Our ability to attract new deposits allowed for an increase in average deposits, and in particular, time deposits. The Company's cost of funds on interest-bearing liabilities has increased to 0.52% for the three months ended March 31, 2016 from 0.40% for the same period in 2015. The higher rate paid was primarily for intermediate term brokered deposits that were acquired in the latter half of 2015 to protect the bank's earnings from a rising rate environment.

The Company's net interest spread of 2.98% decreased 14 basis points for the three months ended March 31, 2016 as compared to the same period in 2015. Net interest margin for the three months ended March 31, 2016 was 3.06%, a 12 basis point decrease from 3.18% for the three months ended March 31, 2015. Maturing loan proceeds were generally reinvested at lower rates due to competitive market conditions. Lowering rates on interest bearing liabilities was not feasible, as they are generally more influenced by changes in short term interest rates.

The table that follows shows average balances and interest yields on a fully taxable equivalent basis (FTE) for the three months ended March 31, 2016 and 2015:

	March 31, 2016				March 31, 2015			
(Dollars in thousands)	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate		Average Balance	Tax Equivalent Interest	Tax Equivalent Rate	
Assets								
Federal funds sold & interest bearing bank balances	$43,242	$ 65	0.60	%	$29,569	$ 26	0.36	%
Securities	363,614	2,142	2.37		356,635	1,905	2.17	
Loans	795,785	8,261	4.18		713,330	7,601	4.32	
Total interest-earning assets	1,202,641	10,468	3.50		1,099,534	9,532	3.52	
Other assets	94,292				81,698			
Total	$1,296,933				$1,181,232			
Liabilities and Shareholders' Equity								
Interest bearing demand deposits	$521,442	$ 252	0.19		$504,387	$ 220	0.18	
Savings deposits	87,702	35	0.16		87,665	34	0.16	
Time deposits	304,800	852	1.12		235,049	523	0.90	
Short term borrowings	76,342	66	0.35		78,370	60	0.31	
Long term debt	24,459	106	1.74		16,112	76	1.91	
Total interest bearing liabilities	1,014,745	1,311	0.52		921,583	913	0.40	
Non-interest bearing demand deposits	133,214				118,866			
Other	13,206				11,166			
Total Liabilities	1,161,165				1,051,615			
Shareholders' Equity	135,768				129,617			
Total	$1,296,933				$1,181,232			
Net interest income (FTE)/net interest spread		9,157	2.98	%		8,619	3.12	%
Net interest margin			3.06	%			3.18	%
Tax-equivalent adjustment		(507)				(304)		
Net interest income		$ 8,650				$ 8,315		

NOTES: Yields and interest income on tax-exempt assets have been computed on a fully taxable equivalent basis assuming a 35% tax rate.

For yield calculation purposes, nonaccruing loans are included in the average loan balance.

41

Table of Contents

Provision for Loan Losses

The Company recorded no provision for loan losses for the three months ended March 31, 2016, and 2015. In determining the required provision for loan losses, both quantitative and qualitative factors are considered in the determination of the adequacy of the allowance for loan losses, as noted in the "Asset Quality" section. For both periods presented, favorable historical charge-off data combined with stable economic and market conditions has resulted in the determination that no additional provision for loan losses were required to offset net charge-offs. Further, no additional reserves were needed on impaired loans, or for loan growth experienced during the three months ended March 31, 2016 and 2015.

See further discussion in the “Allowance for Loan Losses” section.

Noninterest Income

Noninterest income, excluding securities gains, totaled $4,245,000 for the three months ended March 31, 2016, compared to $3,839,000 for the same period in 2015. Several factors contributed to the net change in noninterest income, excluding security gains, for the first three months of 2016 compared to the same period in 2015, as noted below.

- The Company experienced an increase in service charges on deposit accounts of $110,000 for the three months ended March 31, 2016 to $1,303,000 compared to the corresponding period in 2015, due principally to revenues generated from new product offerings and higher interchange fees associated with increased usage.

- Trust department and brokerage income was $1,785,000 for the three months ended March 31, 2016, an increase of $101,000, or 6.0% from the same period in 2015. Revenues were favorably impacted in 2016 by the recognition of several estate fees, which resulted in volatility between periods.

- Favorable real estate and interest rate market conditions led to the increases in mortgage banking revenues, which generated income of $642,000 for the three months ended March 31, 2016, compared to $520,000 for the corresponding period in 2015.

- Earnings on life insurance totaled $268,000 for the three months ended March 31, 2016, an increase of $39,000, or 17.0%, over the same period in 2015, due principally to additional life insurance purchased in 2015 to fund a new compensation arrangement.

Securities gains totaled $1,420,000 for the three months ended March 31, 2016 compared to $1,529,000 for the same period in 2015. For all periods, asset/liability management strategies and interest rate conditions resulted in gains on sales of securities, as market conditions presented opportunities to accelerate earnings on securities through gains, while also meeting the funding requirements of lending activity.

Noninterest Expenses

Noninterest expenses totaled $11,121,000 for the three months ended March 31, 2016, compared to $10,506,000 for the corresponding prior year period. The changes in certain components of noninterest expenses for the three months ended March 31, 2016 and 2015, are described below.

- Salaries and employee benefits increased $283,000 or 4.8%, from $5,900,000 for the three months ended March 31, 2015 to $6,183,000 for the same period in 2016. The higher expenses in 2016 were due to merit increases, additional employees, as well as higher costs associated with incentive based compensation as additional share-based awards were granted and the prior year's awards had a full quarters' worth of expense in 2016.

- Occupancy expense of $526,000 for the three months ended March 31, 2016 represented a decrease of $98,000 from the same period in 2015, due in part to more favorable weather conditions, and less snow removal services in 2016 compared to the prior year.

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Data processing costs of $635,000 for the three months ended March 31, 2016, increased $124,000 compared to $511,000 for the same period in 2015. The increase in costs is reflective of overall higher volumes and costs associated with new and more sophisticated product and service offerings.

- Advertising and bank promotion expense increased from $245,000 for the three months ended March 31, 2015 to $456,000 for corresponding period in 2016, due primarily to $100,000 of incremental educational improvement tax

Table of Contents

credit ("EITC") contributions that carried over to the first quarter of 2016, and increased advertising and promotion expenditures as we continue to promote the Orrstown brand in the markets we presently serve.

- Directors' compensation totaled $231,000 for the three months ended March 31, 2016, a 47.1% increase over $157,000 for the same period in 2015. The increase is principally due to an increase in directors' compensation that resulted from the issuance of restricted stock in May 2015 that had a full quarter of expense totaling $43,000 in 2016 with no corresponding expense in 2015. The remainder of the increase is attributable to two new directors added in 2016, and related compensation paid to them for their services.

- Taxes, other than income, decreased $71,000 from $226,000 for the three months ended March 31, 2015 to $155,000 for the three months ended March 31, 2016. As a result of the incremental EITC contributions made in the first quarter of 2016, a corresponding $90,000 credit was recognized on our Bank Shares Tax liability, and reduced the tax expense for the period.

- Other operating expenses of $914,000 for the three months ended March 31, 2016 represented a $140,000 increase over the $774,000 expensed in the corresponding period in 2015. Included in this category is an increase of $115,000 in the provision for off-balance sheet reserves on loans that have been committed to borrowers, but not funded. The growth in commitments to fund loans has been consistent with growth we have seen in our loan portfolio.

The Company’s efficiency ratio improved slightly for the three months ended March 31, 2016 to 82.6%, compared to 83.8% for the same period in 2015. The improvement in the ratio was primarily the result of the increase in net interest income and noninterest income exceeding the increase in noninterest expenses. The efficiency ratio expresses noninterest expense as a percentage of tax equivalent net interest income and noninterest income, excluding securities gains, intangible asset amortization and other real estate income and expenses.

Income Tax Expense

Income tax expense totaled $614,000, or an effective tax rate of 19.2% for the three months ended March 31, 2016, compared to $715,000, or 22.5% of pre-tax earnings, for the three months ended March 31, 2015. The Company’s effective tax rate is significantly less than the federal statutory rate of 35.0% principally due to tax-free income, including interest earned on tax-free loans and securities, and earnings on the cash surrender value of life insurance policies. The lower effective tax rate for the three months ended March 31, 2016 compared to the same period in 2015 is the result of a larger percentage of pre-tax income being tax-free, combined with additional federal income tax credits in the current year’s results.

FINANCIAL CONDITION

A substantial amount of time is devoted by management to overseeing the investment of funds in loans and securities and the formulation of policies directed toward the profitability and minimization of risk associated with such investments.

Securities Available for Sale

The Company utilizes securities available for sale as a tool for managing interest rate risk to enhance income through interest and dividend income, to provide liquidity and to provide collateral for certain deposits and borrowings. As of March 31, 2016, securities available for sale were $327,590,000, a decrease of $66,534,000, from December 31, 2015’s balance of $394,124,000. As a result of interest rate market conditions, the Company liquidated its government sponsored enterprise commercial mortgage obligations portfolio with an amortized cost of $63,598,000, and fair value of $63,770,000 at December 31, 2015, at a net gain of $1,420,000, and used the proceeds to fund loan demand, including liquidity for loans that will fund after the end of the quarter.

Loan Portfolio

The Company offers various products to meet the credit needs of our borrowers, principally consisting of commercial real estate loans, commercial and industrial loans, and retail loans consisting of loans secured by residential properties, and to a lesser extent, installment loans. No loans are extended to non-domestic borrowers or governments.

Table of Contents

The risks associated with lending activities differ among the various loan classes, and are subject to the impact of changes in interest rates, market conditions of collateral securing the loans, and general economic conditions. All of these factors may adversely impact the borrower's ability to repay its loans, and impact the associated collateral. See Note 3, "Loans Receivable and Allowance for Loan Losses," in the Notes to the Consolidated Financial Statements for a detailed description of the Company's loan classes and differing levels of credit risk associated with each class, which information is incorporated herein by reference.

The loan portfolio, excluding residential loans held for sale, broken out by classes as of March 31, 2016 and December 31, 2015 was as follows:

(Dollars in thousands)	March 31, 2016	December 31, 2015
Commercial real estate:		
Owner-occupied	$ 106,464	$ 103,578
Non-owner occupied	154,731	145,401
Multi-family	37,664	35,109
Non-owner occupied residential	54,834	54,175
Acquisition and development:		
1-4 family residential construction	7,270	9,364
Commercial and land development	42,245	41,339
Commercial and industrial	77,277	73,625
Municipal	62,302	57,511
Residential mortgage:		
First lien	125,706	126,022
Home equity - term	16,578	17,337
Home equity - lines of credit	111,770	110,731
Installment and other loans	7,862	7,521
	$ 804,703	$ 781,713

The loan portfolio at March 31, 2016 of $804,703,000 reflected an increase of $22,990,000, or 2.9%, from $781,713,000 at December 31, 2015. Growth was experienced in nearly all loan segments from December 31, 2015 to March 31, 2016, with the largest increase coming in the commercial real estate segment, which grew by $15,430,000, representing two-thirds of the total loan growth. The Company's increased sales efforts and additional relationship managers have resulted in growth, as we capitalize on disruption in the market that has been caused by the acquisition of some of the competitors in the markets served by larger institutions.

Asset Quality

Risk Elements

The Company's loan portfolios are subject to varying degrees of credit risk. Credit risk is mitigated through the Company's underwriting standards, on-going credit review, and monitoring of asset quality measures. Additionally, loan portfolio diversification, limiting exposure to a single industry or borrower, and requiring collateral also mitigate the Company's risk of credit loss.

The Company's loan portfolio is principally to borrowers in south central Pennsylvania and Washington County, Maryland. As the majority of loans are concentrated in this geographic region, a substantial portion of the debtor's ability to honor their obligations may be affected by the level of economic activity in the market area.

Nonperforming assets include nonaccrual loans and foreclosed real estate. In addition, restructured loans still accruing and loans past due 90 days or more and still accruing are also deemed to be risk assets. For all loan classes, generally the accrual of interest income ceases when principal or interest is past due 90 days or more and collateral is inadequate to cover principal and interest or immediately if, in the opinion of management, full collection is unlikely. Interest will continue to accrue on loans past due 90 days or more if the collateral is adequate to cover principal and interest, and the loan is in the process of collection. Interest accrued, but not collected, as of the date of placement on nonaccrual status, is generally reversed

44

Table of Contents

and charged against interest income, unless fully collateralized. Subsequent payments received are either applied to the outstanding principal balance or recorded as interest income, depending on management's assessment of the ultimate collectability of principal. Loans are returned to accrual status, for all loan classes, when all the principal and interest amounts contractually due are brought current, the loans have performed in accordance with the contractual terms of the note for a reasonable period of time, generally six months, and the ultimate collectability of the total contractual principal and interest is reasonably assured. Past due status is based on contract terms of the loan.

Loans, the terms of which are modified, are classified as TDRs if a concession was granted, for legal or economic reasons, related to a debtor's financial difficulties. Concessions granted under a TDR typically involve a temporary deferral of scheduled loan payments, an extension of a loan's stated maturity date, temporary reduction in interest rates, or below market rates. If a modification occurs while the loan is on accruing status, it will continue to accrue interest under the modified terms. Nonaccrual TDRs are restored to accrual status if scheduled principal and interest payments, under the modified terms, are current for six months after modification, and the borrower continues to demonstrate its ability to meet the modified terms. TDRs are evaluated individually for impairment if they have been restructured during the most recent calendar year, or if they are not performing according to their modified terms.

The following table presents the Company's risk elements, including information concerning the aggregate balances of nonaccrual, restructured loans still accruing, loans past due 90 days or more, and foreclosed real estate as of March 31, 2016, December 31, 2015 and March 31, 2015. Relevant asset quality ratios are also presented.

(Dollars in thousands)	March 31, 2016		December 31, 2015		March 31, 2015	
Nonaccrual loans (cash basis)	$15,906		$ 16,557		$13,888	
Other real estate (OREO)	495		710		1,431	
Total nonperforming assets	16,401		17,267		15,319	
Restructured loans still accruing	1,044		793		1,096	
Loans past due 90 days or more and still accruing	1		24		0	
Total risk assets	$17,446		$ 18,084		$16,415	
Loans 30-89 days past due	$1,391		$ 2,532		$1,631	
Asset quality ratios:						
Nonaccrual loans to loans	1.98	%	2.12	%	1.91	%
Nonperforming assets to assets	1.27	%	1.34	%	1.29	%
Total nonperforming assets to total loans and OREO	2.04	%	2.21	%	2.10	%
Total risk assets to total loans and OREO	2.17	%	2.31	%	2.25	%
Total risk assets to total assets	1.36	%	1.40	%	1.38	%
Allowance for loan losses to total loans	1.66	%	1.74	%	1.99	%
Allowance for loan losses to nonaccrual loans	83.91	%	81.95	%	104.13	%
Allowance for loan losses to nonaccrual and restructured loans still accruing	78.74	%	78.20	%	96.51	%

Risk assets, defined as nonaccrual loans, restructured loans, loans past due 90 days or more and still accruing, and other real estate owned, totaled $17,446,000 at March 31, 2016, a decrease of $638,000, or 3.5%, from the balance at December 31, 2015 of $18,084,000, and an increase of $1,031,000, or 6.3% from March 31, 2015. In efforts by Company personnel to work through risk assets in order to reduce the risk of future credit losses in the portfolio, one relationship totaling $6,692,000 was identified in the third quarter of 2015 with potential weaknesses, and was moved to nonaccrual status. In connection with the evaluation of this impaired loan, it was determined that the Company was adequately secured, and no reserve allocation or partial charge-off was required at this time. The Company continues to work through risk assets in order to reduce the level of nonperforming assets and the risk of future credit losses.

Table of Contents

A further breakdown of impaired loans at March 31, 2016 and December 31, 2015 is as follows:

(Dollars in thousands)	March 31, 2016 Nonaccrual Loans	Restructured Loans Still Accruing	Total	December 31, 2015 Nonaccrual Loans	Restructured Loans Still Accruing	Total
Commercial real estate:						
Owner occupied	$2,029	$ 0	$2,029	$2,109	$ 0	$2,109
Non-owner occupied	7,686	0	7,686	7,856	0	7,856
Multi-family	225	0	225	233	0	233
Non-owner occupied residential	830	0	830	895	0	895
Acquisition and development						
Commercial and land development	3	0	3	5	0	5
Commercial and industrial	714	0	714	734	0	734
Residential mortgage:						
First lien	3,737	1,044	4,781	4,015	793	4,808
Home equity - term	99	0	99	103	0	103
Home equity - lines of credit	567	0	567	590	0	590
Installment and other loans	16	0	16	17	0	17
	$15,906	$ 1,044	$16,950	$16,557	$ 793	$17,350

As of March 31, 2016, the Company had 83 lending relationships with loans that were considered impaired, and were included in the impaired loan balance of $16,950,000, compared to 84 lending relationships with an impaired loan balance of $17,350,000 at December 31, 2015. The exposure to these borrowers with impaired loans is summarized in the following table, along with the partial charge-offs taken to date and the specific reserves established on the relationships at March 31, 2016 and December 31, 2015.

(Dollars in thousands)	# of Relationships	Recorded Investment	Partial Charge-offs to Date	Specific Reserves
March 31, 2016				
Relationships greater than $1,000,000	1	$ 6,393	$ 0	$ 0
Relationships greater than $500,000 but less than $1,000,000	2	1,416	620	0
Relationships greater than $250,000 but less than $500,000	6	2,603	120	40
Relationships less than $250,000	74	6,538	1,345	109
	83	$ 16,950	$ 2,085	$ 149
December 31, 2015				
Relationships greater than $1,000,000	1	$ 6,542	$ 0	$ 0
Relationships greater than $500,000 but less than $1,000,000	2	1,578	475	164
Relationships greater than $250,000 but less than $500,000	7	2,659	188	0
Relationships less than $250,000	74	6,571	1,294	125
	84	$ 17,350	$ 1,957	$ 289

The Company takes partial charge-offs on collateral-dependent loans whose carrying value exceeded their estimated fair value, as determined by the most recent appraisal adjusted for current (within the quarter) conditions, less costs to dispose. ASC 310 impairment reserves remain in those situations in which updated appraisals are pending, and represent management’s estimate of potential loss, or on restructured loans that are still accruing, and the impairment is based on discounted cash flows.

Of the relationships deemed to be impaired at March 31, 2016, one had an outstanding book balance in excess of $1,000,000. Seventy-four (74) of the relationships, or 89% of the total number of impaired relationships, have recorded balances less than $250,000, which reduces the likelihood of a large loss on one particular loan.

The largest impaired loan relationship, with an outstanding loan balance of $6,616,000 migrated to impaired status during the third quarter of 2015. Despite the loan being current as to both principal and interest, the Company moved this loan secured by non-owner occupied commercial property to impaired status as the long-term revenue stream and the guarantors'

Table of Contents

ability to keep the loan current have weakened. The Company believes the loan is well secured, and no loss is anticipated at this time.

In its individual loan impairment analysis, the Company determines the extent of any full or partial charge-offs that may be required, or any ASC 310 reserves that may be needed. The determination of the Company's charge-offs or impairment reserve determination included an evaluation of the outstanding loan balance, and the related collateral securing the credit. Through a combination of collateral securing the loans and partial charge-offs taken to date, the Company believes that it has adequately provided for the potential losses that it may incur on these relationships as of March 31, 2016. However, over time, additional information may become known that could result in increased reserve allocations or, alternatively, it may be deemed that the reserve allocations exceed those that are needed.

The Company's foreclosed real estate balance of $495,000 consists of nine properties owned by the Company, five of which were commercial properties and totaled $155,000, and four residential properties that totaled $340,000. All properties have carrying values of $130,000 or less and are carried at the lower of cost or fair value, less costs to dispose.

As of March 31, 2016, the Company believes the value of foreclosed assets represents their fair values, but if the real estate market remains challenging, additional charges may be needed.

Credit Risk Management

Allowance for Loan Losses

The Company maintains the allowance for loan losses at a level believed adequate by management for probable incurred credit losses. The allowance is established and maintained through a provision for loan losses charged to earnings. Quarterly, management assesses the adequacy of the allowance for loan losses utilizing a defined methodology, which considers specific credit evaluation of impaired loans, past loan loss historical experience, and qualitative factors. Management believes the approach properly addresses the requirements of ASC Section 310-10-35 for loans individually identified as impaired, and ASC Subtopic 450-20 for loans collectively evaluated for impairment, and other bank regulatory guidance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. See Note 3, "Loans Receivable and Allowance for Loan Losses" in the Notes to the Consolidated Financial Statements for a description of the methodology for establishing the allowance and provision for loan losses and related procedures in establishing the appropriate level of reserve, which information is incorporated herein by reference.

Table of Contents

The following tables summarize the Bank's ratings based on its internal risk rating system as of March 31, 2016 and December 31, 2015:

(Dollars in thousands)	Pass	Special Mention	Non-Impaired Substandard	Impaired - Substandard	Doubtful	Total
March 31, 2016						
Commercial real estate:						
Owner-occupied	$98,959	$1,771	$ 3,705	$ 2,029	$ 0	$106,464
Non-owner occupied	134,518	12,419	108	7,686	0	154,731
Multi-family	34,863	1,763	813	225	0	37,664
Non-owner occupied residential	51,490	1,282	1,231	792	39	54,834
Acquisition and development:						
1-4 family residential construction	7,270	0	0	0	0	7,270
Commercial and land development	41,105	215	922	3	0	42,245
Commercial and industrial	74,651	1,352	560	714	0	77,277
Municipal	62,302	0	0	0	0	62,302
Residential mortgage:						
First lien	120,882	0	44	4,780	0	125,706
Home equity - term	16,478	0	1	99	0	16,578
Home equity - lines of credit	110,850	251	102	567	0	111,770
Installment and other loans	7,846	0	0	9	7	7,862
	$761,214	$19,053	$ 7,486	$ 16,904	$ 46	$804,703
December 31, 2015						
Commercial real estate:						
Owner-occupied	$96,715	$1,124	$ 3,630	$ 2,109	$ 0	$103,578
Non-owner occupied	125,043	12,394	108	7,856	0	145,401
Multi-family	31,957	1,779	1,140	233	0	35,109
Non-owner occupied residential	50,601	1,305	1,374	895	0	54,175
Acquisition and development:						
1-4 family residential construction	9,364	0	0	0	0	9,364
Commercial and land development	40,181	219	934	5	0	41,339
Commercial and industrial	70,967	1,380	544	734	0	73,625
Municipal	57,511	0	0	0	0	57,511
Residential mortgage:						
First lien	121,214	0	0	4,808	0	126,022
Home equity - term	17,234	0	0	103	0	17,337
Home equity - lines of credit	109,731	230	180	590	0	110,731
Installment and other loans	7,504	0	0	17	0	7,521
	$738,022	$18,431	$ 7,910	$ 17,350	$ 0	$781,713

Potential problem loans are defined as performing loans, which have characteristics that cause management to have concerns as to the ability of the borrower to perform under present loan repayment terms and which may result in the reporting of these loans as non-performing loans in the future. Generally, management feels that "Substandard" loans that are currently performing and not considered impaired, result in some doubt as to the borrower's ability to continue to perform under the terms of the loan, and represent potential problem loans. Additionally, the "Special Mention" classification is intended to be a temporary classification, and is reflective of loans that have potential weaknesses that may, if not monitored or corrected, weaken the asset or inadequately protect the Bank's position at some future date. "Special Mention" loans represent an elevated risk, but their weakness does not yet justify a more severe, or classified rating. These loans require follow-up by lenders on the cause of the potential weakness, and once resolved, the loan classification may be downgraded to "Substandard," or alternatively, could be upgraded to "Pass."

Table of Contents

Activity in the allowance for loan losses for the three months ended March 31, 2016 and 2015 was as follows:

(Dollars in thousands)	Commercial Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Consumer Residential Mortgage	Installment and Other	Total	Unallocated	Total
March 31, 2016										
Balance, beginning of period	$7,883	$ 850	$ 1,012	$ 58	$9,803	$2,870	$ 121	$2,991	$ 774	$13,568
Provision for loan losses	33	(111)	37	4	(37)	45	102	147	(110)	0
Charge-offs	0	0	(21)	0	(21)	(244)	(64)	(308)	0	(329)
Recoveries	80	0	2	0	82	6	20	26	0	108
Balance, end of period	$7,996	$ 739	$ 1,030	$ 62	$9,827	$2,677	$ 179	$2,856	$ 664	$13,347
March 31, 2015										
Balance, beginning of period	$9,462	$ 697	$ 806	$ 183	$11,148	$2,262	$ 119	$2,381	$ 1,218	$14,747
Provision for loan losses	(63)	(87)	(137)	(62)	(349)	494	15	509	(160)	0
Charge-offs	(66)	(22)	(26)	0	(114)	(201)	(20)	(221)	0	(335)
Recoveries	13	0	22	0	35	12	2	14	0	49
Balance, end of period	$9,346	$ 588	$ 665	$ 121	$10,720	$2,567	$ 116	$2,683	$ 1,058	$14,461

The allowance for loan losses totaled $13,347,000 at March 31, 2016, a decrease of $221,000 from $13,568,000 at December 31, 2015, due to net charge-offs for the period. The allowance for loan losses to nonaccrual loans totaled 83.9% at March 31, 2016 compared to 82.0% at December 31, 2015, and the allowance for loan losses to nonaccrual loans and restructured loans still accruing totaled 78.7% at March 31, 2016, compared to 78.2% at December 31, 2015. Management believes the allowance for loan losses to total loans ratio remains adequate at 1.66% as of March 31, 2016. Classified loans, defined as loans rated substandard, doubtful or loss, totaled $24,436,000 at March 31, 2016, or approximately 3.0% of total loans outstanding, and decreased from $25,260,000 at December 31, 2015, or 3.2% of loans outstanding.

Net charge-offs were $221,000 for the three months ended March 31, 2016, compared to $286,000 for the same period in 2015, resulting in a ratio of annualized net charge-offs to average loans outstanding of 0.11% for the three months ended March 31, 2016 and 0.16% for the same period in 2015. Favorable historical charge-off data combined with stable economic and market conditions has resulted in the determination that no additional provision for loan losses were required to offset net charge-offs and no additional reserves were needed on impaired loans or for loan growth experienced during both periods, as more fully discussed in the "Provision for Loan Losses" section in this Management and Discussion and Analysis.

Table of Contents

The following summarizes the ending loan balances individually or collectively evaluated for impairment based upon loan type, as well as the allowance for loan losses allocation for each at March 31, 2016 and December 31, 2015.

(Dollars in thousands)	Commercial Commercial Real Estate	Commercial Acquisition and Development	Commercial and Industrial	Municipal	Total	Consumer Residential Mortgage	Installment and Other	Total	Unallocated	Total
March 31, 2016										
Loans allocated by:										
Individually evaluated for impairment	$10,771	$ 3	$ 714	$0	$11,488	$5,446	$ 16	$5,462	$ 0	$16,950
Collectively evaluated for impairment	342,922	49,512	76,563	62,302	531,299	248,608	7,846	256,454	0	787,753
	$353,693	$ 49,515	$ 77,277	$62,302	$542,787	$254,054	$ 7,862	$261,916	$ 0	$804,703
Allowance for loan losses allocated by:										
Individually evaluated for impairment	$39	$ 0	$ 0	$0	$39	$103	$ 7	$110	$ 0	$149
Collectively evaluated for impairment	7,957	739	1,030	62	9,788	2,574	172	2,746	664	13,198
	$7,996	$ 739	$ 1,030	$62	$9,827	$2,677	$ 179	$2,856	$ 664	$13,347
December 31, 2015										
Loans allocated by:										
Individually evaluated for impairment	$11,093	$ 5	$ 734	$0	$11,832	$5,501	$ 17	$5,518	$ 0	$17,350
Collectively evaluated for impairment	327,170	50,698	72,891	57,511	508,270	248,589	7,504	256,093	0	764,363
	$338,263	$ 50,703	$ 73,625	$ 57,511	$520,102	$254,090	$ 7,521	$261,611	$ 0	$781,713
Allowance for loan losses allocated by:										
Individually evaluated for impairment	$0	$ 0	$ 0	$ 0	$0	$281	$ 8	$289	$ 0	$289
Collectively evaluated for impairment	7,883	850	1,012	58	9,803	2,589	113	2,702	774	13,279
	$7,883	$ 850	$ 1,012	$ 58	$9,803	$2,870	$ 121	$2,991	$ 774	$13,568

The allowance for loan losses allocations presented above represent the reserve allocations on loan balances outstanding at March 31, 2016 and December 31, 2015. In addition to the reserve allocations on impaired loans noted above, 21 loans, with aggregate outstanding general ledger principal balances of $3,841,000, have had cumulative partial charge-offs to the allowance for loan losses recorded totaling $2,085,000 at March 31, 2016. As updated appraisals were received on collateral dependent loans, partial charge-offs were taken to the extent the loans' principal balance exceeded their fair value.

Management believes the allocation of the allowance for loan losses between the various loan segments adequately reflects the probable incurred credit losses in each portfolio, and is based on the methodology outlined in "Note 3 – Loans Receivable and Allowance for Loan Losses" included in the Notes to the Consolidated Financial Statements. Management re-evaluates and makes certain enhancements to its methodology used to establish a reserve to better reflect the risks inherent in the different segments of the portfolio, particularly in light of changes in levels of charge-offs, with noticeable differences between the different loan segments. Management believes these enhancements to the allowance for loan losses methodology improve the accuracy of quantifying losses presently inherent in the portfolio. Management charges actual loan losses to the reserve and bases the provision for loan losses on the overall analysis taking the methodology into account.

The unallocated portion of the allowance for loan losses reflects estimated probable incurred losses within the portfolio that have not been identified to specific loans or portfolio segments. This reserve results due to risk of error in the specific and general reserve allocation, other potential exposure in the loan portfolio, variances in management's assessment of national and local economic conditions and other factors management believes appropriate at the time. The unallocated portion of the allowance has decreased from $774,000 at December 31, 2015 to $664,000 at March 31, 2016 and represents 5.0% of the entire allowance for loan losses balance at March 31, 2016.

While management believes the Company's allowance for loan losses is adequate based on information currently available, future adjustments to the reserve and enhancements to the methodology may be necessary due to changes in economic conditions, regulatory guidance, or management's assumptions as to future delinquencies or loss rates.

Table of Contents

Deposits

Total deposits were $1,048,376,000 at March 31, 2016, an increase of $16,209,000, or 1.6%, from $1,032,167,000 at December 31, 2015. Non-interest bearing deposits comprised the majority of the increase, and totaled $146,094,000 at March 31, 2016. The Company has been able to gather additional non-interest bearing deposits as it increases it commercial relationships. The additional deposits that the Company obtained in the first quarter of 2016 were used to pay down short-term borrowings.

Capital Adequacy and Regulatory Matters

Capital Resources. The management of capital in a regulated financial services industry must properly balance return on equity to its stockholders while maintaining sufficient levels of capital and related risk-based regulatory capital ratios to satisfy statutory regulatory requirements. The Company's capital management strategies have historically been developed to provide attractive rates of returns to its shareholders, while maintaining a "well capitalized" position of regulatory strength.

Shareholders' equity totaled $138,247,000 at March 31, 2016, an increase of $5,186,000 or 3.9%, from $133,061,000 at December 31, 2015. This increase was primarily the result of an increase in accumulated other comprehensive income, net of taxes of $3,235,000 and net income of $2,580,000 for the three months ended March 31, 2016, offset by dividends declared on common stock of $664,000.

Capital Adequacy. The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Although applicable to the Bank, prompt corrective action provisions are not applicable to bank holding companies, including financial holding companies.

Quantitative measures established by regulators to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (as set forth in the following table) of total and Tier 1 capital (as defined in regulations) to risk-weighted assets (as defined), common equity Tier 1 capital (as defined) to risk weighted assets, and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of March 31, 2016 and December 31, 2015, the Company and the Bank meet all capital adequacy requirements to which they are subject.

Effective January 1, 2015, the Company and the Bank became subject to the Basel III Capital Rules, which substantially revised the risk-based capital requirements in comparison to the previously effective U.S. risk-based capital rules. The Basel III Capital Rules, among other things, (i) introduced a new capital measure called "Common Equity Tier 1" ("CET1"), (ii) increased the minimum requirements for Tier 1 Capital ratio as well as the minimum levels to be considered well capitalized under prompt corrective action; (iii) and introduced the "capital conservation buffer", designed to absorb losses during periods of economic stress. Institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer are subject to constraints on dividends, equity repurchases and discretionary bonuses to executive officers based on the amount of the shortfall.

Under the Basel III Capital Rules, the Company and Bank took the one-time option to permanently opt out of the requirement to include most components of accumulated other comprehensive income ("AOCI"), including unrealized gains or losses on certain securities available for sale, in regulatory capital. The Company and Bank made the one-time permanent election to opt out, with the result that most AOCI items will be excluded from regulatory capital.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. As of March 31, 2016, $7,255,000 of the Company's deferred tax asset was disallowed for Tier 1, CET1 and Total risk based capital, as it relates to operating loss and tax credit carryforwards which are not permissible as capital under Basel III Capital Rules.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter until fully phased-in at January 1, 2018). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and be

51

Table of Contents

phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

The Basel III Capital Rules prescribe a standardized approach for risk weightings that expands the risk-weighting categories from the four categories of the previous capital standards (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. Significant provisions of the Basel III Capital Rules that impact the Company's capital calculations include, among other things:

- Restricting the amount of deferred tax assets that can be included in CET1 capital with assets relating to net operating loss and credit carry forwards being excluded, and a 10% - 15% limitation on deferred tax assets arising from temporary differences that cannot be realized through net operating loss carry backs.
- Applying a 150% risk weight for certain high volatility commercial real estate acquisition, development and construction loans;
- Assigning a 150% risk weight to exposures (other than residential mortgage exposures) that are 90 days past due or in nonaccrual status; and
- Providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable.

The allowance for credit losses, including the allowance for loan losses and reserve for off-balance sheet credit commitments, is included as Tier 2 capital to the extent it does not exceed 1.25% of risk weighted assets. The amount that exceeds 1.25% of risk weighted assets, is disallowed as Tier 2 capital, but also reduces the Company’s risk weighted assets. As of March 31, 2016, $2,902,000 of the allowance for credit losses was excluded from Tier 2 capital.

Table of Contents

Regulatory Capital. As of March 31, 2016 and December 31, 2015, the Bank was considered well capitalized under applicable banking regulations. The Company's and the Bank's capital ratios as of March 31, 2016 and December 31, 2015 were as follows:

	Actual		Minimum Capital Requirement		Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2016						
Total capital to risk weighted assets						
Orrstown Financial Services, Inc.	$137,389	15.7%	$ 70,181	8.0 %	n/a	n/a
Orrstown Bank	121,703	13.9%	70,133	8.0 %	$ 87,666	10.0 %
Tier 1 capital to risk weighted assets						
Orrstown Financial Services, Inc.	126,352	14.4%	52,636	6.0 %	n/a	n/a
Orrstown Bank	110,673	12.6%	52,599	6.0 %	70,133	8.0 %
CET1 to risk weighted assets						
Orrstown Financial Services, Inc.	126,352	14.4%	39,477	4.5 %	n/a	n/a
Orrstown Bank	110,673	12.6%	39,450	4.5 %	56,983	6.5 %
Tier 1 capital to average assets						
Orrstown Financial Services, Inc.	126,352	9.8 %	51,579	4.0 %	n/a	n/a
Orrstown Bank	110,673	8.6 %	51,609	4.0 %	64,511	5.0 %
December 31, 2015						
Total capital to risk weighted assets						
Orrstown Financial Services, Inc.	$134,562	15.8%	$ 68,078	8.0 %	n/a	n/a
Orrstown Bank	118,671	14.0%	68,027	8.0 %	$ 85,034	10.0 %
Tier 1 capital to risk weighted assets						
Orrstown Financial Services, Inc.	123,825	14.6%	51,058	6.0 %	n/a	n/a
Orrstown Bank	107,942	12.7%	51,021	6.0 %	68,027	8.0 %
CET1 to risk weighted assets						
Orrstown Financial Services, Inc.	123,825	14.6%	38,294	4.5 %	n/a	n/a
Orrstown Bank	107,942	12.7%	38,265	4.5 %	55,272	6.5 %
Tier 1 capital to average assets						
Orrstown Financial Services, Inc.	123,825	9.8 %	50,684	4.0 %	n/a	n/a
Orrstown Bank	107,942	8.5 %	50,695	4.0 %	63,368	5.0 %

As noted above, the Bank's capital ratios exceed the regulatory minimums to be considered well capitalized under applicable banking regulations. The Company routinely evaluates its capital levels in light of its risk profile to assess its capital needs. In addition to the minimum capital ratio requirement and minimum capital ratio to be well capitalized presented above, the Company must maintain a capital conservation buffer as discussed above. As of the March 31, 2016, the Company's capital conservation buffer, based on the most restrictive capital ratio, is 7.66%, well above the phase in requirements of 0.625% for December 31, 2016.

On January 19, 2016, the Company filed a shelf registration statement on Form S-3 with the SEC, covering up to an aggregate of $100,000,000 of securities, through the sale of common stock, preferred stock, warrants, debt securities, and units. To date, the Company has not issued any securities under this shelf registration.

In October 2011, the Company announced it had discontinued its quarterly dividend, which was the result of regulatory guidance from the Federal Reserve Bank. Under the Written Agreement entered into with the Federal Reserve Bank in March 2012, the Company was restricted from paying any dividends or repurchasing any stock without prior regulatory approval. The Written Agreement was terminated by the Federal Reserve Bank on April 1, 2015, and the Company resumed its quarterly dividend to common stockholders in April 2015.

53

Table of Contents

On September 14, 2015, the Board of Directors of the Company authorized a stock repurchase program under which Orrstown Financial Services, Inc. may repurchase up to 5% of the Company's outstanding shares of common stock, or approximately 416,000 shares, in the open market, in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended. The extent to which the Company repurchases its shares, and the timing of such repurchases, will depend upon a variety of factors, including market conditions, regulatory requirements and other corporate considerations, as determined by management. Purchases may be made from time to time on open market or privately negotiated transactions. The repurchase program may be suspended or discontinued at any time. As of March 31, 2016, 61,298 shares had been repurchased under the program at a total cost of $1,051,000, or $17.15 per share.

Liquidity

The primary function of asset/liability management is to ensure adequate liquidity and manage the Company’s sensitivity to changing interest rates. Liquidity management involves the ability to meet the cash flow requirements of customers who may be either depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. Our primary sources of funds consist of deposit inflows, loan repayments, maturities and sales of investment securities, the sale of mortgage loans and borrowings from the Federal Home Loan Bank of Pittsburgh. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly adjust our investments in liquid assets based upon our assessment of (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities and (4) the objectives of our asset/liability management policy.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the exposure to interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market rate or price risks. For domestic banks, including the Company, the majority of market risk is related to interest rate risk. Interest rate sensitivity management requires the maintenance of an appropriate balance between reward, in the form of net interest margin, and risk as measured by the amount of earnings and value at risk.

Interest Rate Risk

Interest rate risk is the exposure to fluctuations in the Company’s future earnings (earnings at risk) and value (value at risk) resulting from changes in interest rates. This exposure results from differences between the amounts of interest earning assets and interest bearing liabilities that reprice within a specified time period as a result of scheduled maturities, scheduled and unscheduled repayments, the propensity of borrowers and depositors to react to changes in their economic interests, and security and contractual interest rate changes.

Management, through its asset/liability management process, attempts to manage the level of repricing and maturity mismatch so that fluctuations in net interest income is maintained within policy limits across a range of market conditions while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent, appropriate and necessary to ensure the Company’s profitability. Thus, the goal of interest rate risk management is to evaluate the amount of reward for taking risk and adjusting both the size and composition of the balance sheet relative to the level of reward available for taking risk.

Management endeavors to control the exposure to changes in interest rates by understanding, reviewing and making decisions based on its risk position. The Company primarily uses the securities portfolio, FHLB advances, and brokered deposits to manage its interest rate risk position. Additionally, pricing, promotion and product development activities are directed in an effort to emphasize the loan and deposit term or repricing characteristics that best meet current interest rate risk objectives. At present, there is no use of hedging instruments.

The asset/liability committee operates under management policies defining guidelines and limits on the level of risk. These policies are approved by the Board of Directors.

The Company uses simulation analysis to assess earnings at risk and net present value analysis to assess value at risk. These methods allow management to regularly monitor both the direction and magnitude of the Company’s interest rate risk exposure. These modeling techniques involve assumptions and estimates that inherently cannot be measured with complete precision. Key assumptions in the analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturity deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies,

Table of Contents

among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Company's interest rate risk position over time.

Earnings at Risk

Simulation analysis evaluates the effect of upward and downward changes in market interest rates on future net interest income. The analysis involves changing the interest rates used in determining net interest income over the next twelve months. The resulting percentage change in net interest income in various rate scenarios is an indication of the Company's short-term interest rate risk. The analysis assumes recent trends in new loan and deposit volumes will continue while the amount of investment securities remains constant. Additional assumptions are applied to modify volumes and pricing under the various rate scenarios. These include prepayment assumptions on mortgage assets, sensitivity of non-maturity deposit rates, and other factors deemed significant.

The simulation analysis results are presented in Table 3a. These results, as of March 31, 2016, indicate that the Company would expect net interest income to decrease over the next twelve months by 2.1% assuming a downward shock in market interest rates of 1.00%, and to increase by 2.2% assuming an upward shock of 2.00%. A decrease in interest rates of 1.00% would create an environment in which deposit rates could not practically decline further, thus decreasing net interest income.

Earnings at risk simulations for March 31, 2016, exhibited greater sensitivity to rising interest rates and similar sensitivity in a declining rate environment, and asset/liability management strategies were taken in the first quarter of 2016 that resulted in a reduction of the Company's risk in an upward interest rate environment.

Value at Risk

Net present value analysis provides information on the risk inherent in the balance sheet that might not be taken into account in the simulation analysis due to the short time horizon used in that analysis. The net present value of the balance sheet is defined as the discounted present value of expected asset cash flows minus the discounted present value of the expected liability cash flows. The analysis involves changing the interest rates used in determining the expected cash flows and in discounting the cash flows. The resulting percentage change in net present value in various rate scenarios is an indication of the longer term repricing risk and options embedded in the balance sheet.

The net present value analysis results are presented in Table 3b. These results, as of March 31, 2016, indicate that the net present value would increase 0.8% assuming a downward shift in market interest rates of 1.00% and increase 6.1% if interest rates shifted up 2.00% in the same manner, and indicates the Company would be positioned better in rises in interest rates than it would if interest rates fell.

Table 3a - Earnings at Risk			Table 3b - Value at Risk		
	% Change in Net Interest Income			% Change in Market Value	
Change in Market Interest Rates	March 31, 2016	December 31, 2015	Change in Market Interest Rates	March 31, 2016	December 31, 2015
(100)	(2.1%)	(1.4 %)	(100)	0.8%	1.8 %
100	0.7 %	(1.2 %)	100	3.6%	0.5 %
200	2.2 %	(1.8 %)	200	6.1%	0.0 %

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of March 31, 2016. Based on such evaluation, such officers have concluded that the Company's disclosure controls and procedures were designed and functioning effectively, as of March 31, 2016, to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

55

Table of Contents

(b) Changes in Internal Control Over Financial Reporting

No change in the Company's internal control over financial reporting occurred during the fiscal quarter ended March 31, 2016, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings

The nature of the Company's business generates a certain amount of litigation involving matters arising out of the ordinary course of business. Except as described below, in the opinion of management, there are no legal proceedings that might have a material effect on the results of operations, liquidity, or the financial position of the Company at this time.

On May 25, 2012, SEPTA filed a putative class action complaint in the United States District Court for the Middle District of Pennsylvania against the Company, the Bank and certain current and former directors and executive officers (collectively, the "Defendants"). The complaint alleges, among other things, that (i) in connection with the Company's Registration Statement on Form S-3 dated February 23, 2010 and its Prospectus Supplement dated March 23, 2010, and (ii) during the purported class period of March 24, 2010 through October 27, 2011, the Company issued materially false and misleading statements regarding the Company's lending practices and financial results, including misleading statements concerning the stringent nature of the Bank's credit practices and underwriting standards, the quality of its loan portfolio, and the intended use of the proceeds from the Company's March 2010 public offering of common stock. The complaint asserts claims under Sections 11, 12(a) and 15 of the Securities Act of 1933, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and seeks class certification, unspecified money damages, interest, costs, fees and equitable or injunctive relief. Under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), motions for appointment of Lead Plaintiff in this case were due by July 24, 2012. SEPTA was the sole movant and the Court appointed SEPTA Lead Plaintiff on August 20, 2012. Pursuant to the PSLRA and the Court's September 27, 2012 Order, SEPTA was given until October 26, 2012 to file an amended complaint and the Defendants until December 7, 2012 to file a motion to dismiss the amended complaint. SEPTA's opposition to the Defendant's motion to dismiss was originally due January 11, 2013. Under the PSLRA, discovery and all other proceedings in the case were stayed pending the Court's ruling on the motion to dismiss. The September 27, 2012 Order specified that if the motion to dismiss were denied, the Court would schedule a conference to address discovery and the filing of a motion for class certification. On October 26, 2012, SEPTA filed an unopposed motion for enlargement of time to file its amended complaint in order to permit the parties and new defendants to be named in the amended complaint time to discuss plaintiff's claims and defendants' defenses. On October 26, 2012, the Court granted SEPTA's motion, mooting its September 27, 2012 scheduling Order, and requiring SEPTA to file its amended complaint on or before January 16, 2013 or otherwise advise the Court of circumstances that require a further enlargement of time. On January 14, 2013, the Court granted SEPTA's second unopposed motion for enlargement of time to file an amended complaint on or before March 22, 2013.

On March 4, 2013, SEPTA filed an amended complaint. The amended complaint expands the list of defendants in the action to include the Company's independent registered public accounting firm and the underwriters of the Company's March 2010 public offering of common stock. In addition, among other things, the amended complaint extends the purported 1934 Exchange Act class period from March 15, 2010 through April 5, 2012. Pursuant to the Court's March 28, 2013 Second Scheduling Order, on May 28, 2013 all defendants filed their motions to dismiss the amended complaint, and on July 22, 2013 SEPTA filed its "omnibus" opposition to all of the defendants' motions to dismiss. On August 23, 2013, all defendants filed reply briefs in further support of their motions to dismiss. On December 5, 2013, the Court ordered oral argument on the Orrstown Defendants' motion to dismiss the amended complaint to be heard on February 7, 2014. Oral argument on the pending motions to dismiss SEPTA's amended complaint was held on April 29, 2014.

The Second Scheduling Order stayed all discovery in the case pending the outcome of the motions to dismiss, and informed the parties that, if required, a telephonic conference to address discovery and the filing of SEPTA's motion for class certification would be scheduled after the Court's ruling on the motions to dismiss.

On April 10, 2015, pursuant to Court order, all parties filed supplemental briefs addressing the impact of the United States Supreme Court's March 24, 2015 decision in Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund on defendants' motions to dismiss the amended complaint.

On June 22, 2015, in a 96-page Memorandum, the Court dismissed without prejudice SEPTA's amended complaint against all defendants, finding that SEPTA failed to state a claim under either the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended. The Court ordered that, within 30 days, SEPTA either seek leave to amend its

Table of Contents

amended complaint, accompanied by the proposed amendment, or file a notice of its intention to stand on the amended complaint.

On July 22, 2015, SEPTA filed a motion for leave to amend under Local Rule 15.1, and attached a copy of its proposed second amended complaint to its motion. Many of the allegations of the proposed second amended complaint are essentially the same or similar to the allegations of the dismissed amended complaint. The proposed second amended complaint also alleges that the Orrstown Defendants did not publicly disclose certain alleged failures of internal controls over loan underwriting, risk management, and financial reporting during the period 2009 to 2012, in violation of the federal securities laws. On February 8, 2016, the Court granted SEPTA's motion for leave to amend and SEPTA filed its second amended complaint that same day.

The allegations of SEPTA's proposed second amended complaint disclosed the existence of a confidential, non-public, fact-finding inquiry regarding the Company being conducted by the Commission. The Commission inquiry is not an indication that the Commission believes the Company or anyone else has violated federal securities laws or regulations. Nor does it mean that the Commission has a negative opinion of any person, entity, or security. The investigation is ongoing and the Company has been cooperating fully with the Commission.

On February 25, 2016, the Court issued a scheduling Order directing: all defendants to file any motions to dismiss by March 18, 2016; SEPTA to file an omnibus opposition to defendants' motions to dismiss by April 8, 2016; and all defendants to file reply briefs in support of their motions to dismiss by April 22, 2016. Defendants timely filed their motions to dismiss the second amended complaint and the parties filed their briefs in accordance with the Court-ordered schedule, above. The February 25, 2016 Order stays all discovery and other deadlines in the case (including the filing of SEPTA's motion for class certification) pending the outcome of the motions to dismiss.

The Company believes that the allegations of SEPTA's second amended complaint are without merit and intends to vigorously defend itself against those claims.

Given that the litigation is still in the pleading stage, it is not possible at this time to estimate reasonably possible losses, or even a range of reasonably possible losses, in connection with the litigation.

Item 1A – Risk Factors

There have been no material changes from the risk factors as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

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

The following table represents the Company's monthly repurchases of its common stock during the quarter ended March 31, 2016:

	Total Number of Shares Repurchased	Average Price Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
January 1, 2016 to January 31, 2016	2,488	$ 17.46	2,488	366,435
February 1, 2016 to February 29, 2016	4,056	17.22	4,056	362,379
March 1, 2016 to March 31, 2016	7,677	17.17	7,677	354,702

On September 14, 2015, the Board of Directors of the Company authorized a stock repurchase program under which Orrstown Financial Services, Inc. may repurchase up to 5% of the Company's outstanding shares of common stock, or approximately 416,000 shares, in the open market, in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended.

The extent to which the Company repurchases its shares, and the timing of such repurchases, will depend upon a variety of factors, including market conditions, regulatory requirements and other corporate considerations, as determined by management. Purchases may be made from time to time on open market or privately negotiated transactions. The repurchase

57

Table of Contents

program may be suspended or discontinued at any time. As of March 31, 2016, 61,298 shares had been repurchased under the program at a total cost of $1,051,000, or $17.15 per share.
The Company did not sell any unregistered securities during the quarter ended March 31, 2016.

Item 3 – Defaults Upon Senior Securities
Not applicable.

Item 4 – Mine Safety Disclosures
Not applicable.

Item 5 – Other Information
None.

Table of Contents

Item 6 – Exhibits

3.1	Articles of Incorporation as amended, incorporated by reference to Exhibit 3.1 of the Registrant's Report on Form 8-K filed on January 29, 2010.
3.2	By-laws as amended, incorporated by reference to Exhibit 3.1 to the Registrant's Report on Form 8-K filed March 1, 2013.
4.1	Specimen Common Stock Certificate, incorporated by reference to the Registrant's Registration Statement on Form S-3 filed February 8, 2010 (File No. 333-164780).
31.1	Rule 13a – 14(a)/15d-14(a) Certification (Principal Executive Officer)
31.2	Rule 13a – 14(a)/15d-14(a) Certifications (Principal Financial Officer)
32.1	Section 1350 Certifications (Principal Executive Officer)
32.2	Section 1350 Certifications (Principal Financial Officer)
101.LAB	XBRL Taxonomy Extension Label Linkbase *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase *
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase *
101.DEF	XBRL Taxonomy Extension Definition Linkbase *

* Attached as Exhibit 101 to this Form 10-Q are documents formatted in XBRL (Extensive Business Reporting Language).

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.

/s/ Thomas R. Quinn, Jr.
Thomas R. Quinn, Jr.
President and Chief Executive Officer
(Principal Executive Officer)

/s/ David P. Boyle
David P. Boyle
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: May 6, 2016

Table of Contents

ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARIES
EXHIBIT INDEX

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All other exhibits for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

* Attached as Exhibits 101 to this Form 10-Q are documents formatted in XBRL (Extensive Business Reporting Language).