ARROW FINANCIAL CORP
Form 10-Q
November 09, 2016

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

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

For the Quarterly Period Ended September 30, 2016

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

Commission File Number: 0-12507

ARROW FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York	22-2448962
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

250 GLEN STREET, GLENS FALLS, NEW YORK 12801
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (518) 745-1000

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes No

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

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

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	Outstanding as of October 31, 2016
Common Stock, par value $1.00 per share	13,467,310

ARROW FINANCIAL CORPORATION
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PART I - FINANCIAL INFORMATION

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

	September 30, 2016	December 31, 2015	September 30, 2015
ASSETS			
Cash and Due From Banks	$ 66,556	$ 34,816	$ 43,870
Interest-Bearing Deposits at Banks	35,503	16,252	25,821
Investment Securities:			
Available-for-Sale	339,190	402,309	397,559
Held-to-Maturity (Approximate Fair Value of $347,441 at September 30, 2016; $325,930 at December 31, 2015; and $324,009 at September 30, 2015)	338,238	320,611	317,480
Federal Home Loan Bank and Federal Reserve Bank Stock	5,371	8,839	5,143
Loans	1,707,216	1,573,952	1,536,925
Allowance for Loan Losses	(16,975)	(16,038)	(15,774)
Net Loans	1,690,241	1,557,914	1,521,151
Premises and Equipment, Net	26,718	27,440	28,186
Goodwill	21,873	21,873	22,003
Other Intangible Assets, Net	2,802	3,107	3,263
Other Assets	53,993	53,027	55,075
Total Assets	$ 2,580,485	$ 2,446,188	$ 2,419,551
LIABILITIES			
Noninterest-Bearing Deposits	$ 381,760	$ 358,751	$ 347,963
NOW Accounts	993,221	887,317	971,252
Savings Deposits	629,201	594,538	568,022
Time Deposits of $100,000 or More	79,222	59,792	60,978
Other Time Deposits	129,783	130,025	133,836
Total Deposits	2,213,187	2,030,423	2,082,051
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	38,589	23,173	24,414
Federal Home Loan Bank Overnight Advances	—	82,000	—
Federal Home Loan Bank Term Advances	55,000	55,000	55,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000
Other Liabilities	24,501	21,621	26,944
Total Liabilities	2,351,277	2,232,217	2,208,409
STOCKHOLDERS’ EQUITY			
Preferred Stock, $5 Par Value; 1,000,000 Shares Authorized	—	—	—
Common Stock, $1 Par Value; 20,000,000 Shares Authorized (17,943,201 Shares Issued at September 30, 2016; 17,420,776 at December 31, 2015 and 17,420,776 at September 30, 2015)	17,943	17,421	17,421
Additional Paid-in Capital	269,680	250,680	249,931
Retained Earnings	25,400	32,139	28,791
	(750)	(1,100)	(1,100)

Unallocated ESOP Shares (38,396 Shares at September 30, 2016; 55,275 Shares at December 31, 2015; and 55,185 Shares at September 30, 2015)			
Accumulated Other Comprehensive Loss	(5,442)	(7,972)	(6,520)
Treasury Stock, at Cost (4,479,257 Shares at September 30, 2016; 4,426,072 Shares at December 31, 2015; and 4,460,654 Shares at September 30, 2015)	(77,623)	(77,197)	(77,381)
Total Stockholders' Equity	229,208	213,971	211,142
Total Liabilities and Stockholders' Equity	$ 2,580,485	$ 2,446,188	$ 2,419,551

See Notes to Unaudited Interim Consolidated Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
INTEREST AND DIVIDEND INCOME				
Interest and Fees on Loans	$15,833	$14,364	$46,565	$41,953
Interest on Deposits at Banks	34	13	100	60
Interest and Dividends on Investment Securities:				
Fully Taxable	1,889	1,979	5,994	5,936
Exempt from Federal Taxes	1,526	1,475	4,486	4,279
Total Interest and Dividend Income	19,282	17,831	57,145	52,228
INTEREST EXPENSE				
NOW Accounts	320	292	941	960
Savings Deposits	231	189	677	538
Time Deposits of $100,000 or More	128	89	313	267
Other Time Deposits	164	179	497	566
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	9	5	24	15
Federal Home Loan Bank Advances	390	353	1,013	804
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	163	146	487	432
Total Interest Expense	1,405	1,253	3,952	3,582
NET INTEREST INCOME	17,877	16,578	53,193	48,646
Provision for Loan Losses	480	537	1,550	882
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	17,397	16,041	51,643	47,764
NONINTEREST INCOME				
Income From Fiduciary Activities	1,923	1,923	5,854	5,907
Fees for Other Services to Customers	2,491	2,331	7,144	6,904
Insurance Commissions	2,127	2,343	6,468	6,849
Net Gain on Securities Transactions	—	—	144	106
Net Gain on Sales of Loans	310	236	649	488
Other Operating Income	263	304	925	1,183
Total Noninterest Income	7,114	7,137	21,184	21,437
NONINTEREST EXPENSE				
Salaries and Employee Benefits	8,693	8,699	25,223	24,577
Occupancy Expenses, Net	2,425	2,275	7,223	7,106
FDIC Assessments	217	297	844	873
Other Operating Expense	3,747	3,579	11,047	10,632
Total Noninterest Expense	15,082	14,850	44,337	43,188
INCOME BEFORE PROVISION FOR INCOME TAXES	9,429	8,328	28,490	26,013
Provision for Income Taxes	2,691	2,395	8,556	7,920
NET INCOME	$6,738	$5,933	$19,934	$18,093
Average Shares Outstanding:				
Basic	13,407	13,275	13,374	13,273

Diluted	13,497	13,317	13,439	13,314
Per Common Share:				
Basic Earnings	$0.50	$0.45	$1.49	$1.36
Diluted Earnings	0.50	0.45	1.48	1.36

Share and Per Share Amounts have been restated for the September 29, 2016 3% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net Income	$6,738	$5,933	$19,934	$18,093
Other Comprehensive Income, Net of Tax:				
Net Unrealized Securities Holding (Losses) Gains Arising During the Period	(810)	543	2,309	384
Reclassification Adjustments for Securities Gains Included in Net Income	—	—	(88)	(65)
Amortization of Net Retirement Plan Actuarial Loss	111	117	314	352
Accretion of Net Retirement Plan Prior Service Credit	(1)	(9)	(5)	(25)
Other Comprehensive Income Gain (Loss)	(700)	651	2,530	646
Comprehensive Income	$6,038	$6,584	$22,464	$18,739

See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unallo-cated ESOP Shares	Accumu-lated Other Com-prehensive Loss	Treasury Stock	Total
Balance at December 31, 2015	$17,421	$250,680	$32,139	$(1,100)	$(7,972)	$(77,197)	$213,971
Net Income	—	—	19,934	—	—	—	19,934
Other Comprehensive Income	—	—	—	—	2,530	—	2,530
3% Stock Dividend (522,425 Shares)	522	16,415	(16,937)	—	—	—	—
Cash Dividends Paid, $.728 per Share	—	—	(9,736)	—	—	—	(9,736)
Stock Options Exercised, Net (80,449 Shares)	—	980	—	—	—	795	1,775
Shares Issued Under the Directors' Stock Plan (3,522 Shares)	—	76	—	—	—	36	112
Shares Issued Under the Employee Stock Purchase Plan (13,041 Shares)	—	229	—	—	—	129	358
Shares Issued for Dividend Reinvestment Plans (44,448 Shares)	—	862	—	—	—	440	1,302
Stock-Based Compensation Expense	—	215	—	—	—	—	215
Tax Benefit from Exercise of Stock Options	—	63	—	—	—	—	63
Purchase of Treasury Stock (64,146 Shares)	—	—	—	—	—	(1,826)	(1,826)
Allocation of ESOP Stock (17,997 Shares)	—	160	—	350	—	—	510
Balance at September 30, 2016	$17,943	$269,680	$25,400	$(750)	$(5,442)	$(77,623)	$229,208
Balance at December 31, 2014	$17,079	$239,721	$29,458	$(1,450)	$(7,166)	$(76,716)	$200,926
Net Income	—	—	18,093	—	—	—	18,093
Other Comprehensive Income	—	—	—	—	646	—	646
2% Stock Dividend (341,400 Shares)	342	8,939	(9,281)	—	—	—	—
Cash Dividends Paid, $.714 per Share [1]	—	—	(9,479)	—	—	—	(9,479)
Stock Options Exercised, Net (24,554 Shares)	—	289	—	—	—	242	531
Shares Issued Under the Directors' Stock Plan (4,579 Shares)	—	73	—	—	—	45	118
Shares Issued Under the Employee Stock Purchase Plan (13,990 Shares)	—	222	—	—	—	137	359
Shares Issued for Dividend Reinvestment Plans (16,112 Shares)	—	281	—	—	—	158	439

Stock-Based Compensation Expense	—	233	—	—	—	—	233
Tax Benefit for Disposition of Stock Options	—	31	—	—	—	—	31
Purchase of Treasury Stock (46,403 Shares)	—	—	—	—	—	(1,247)	(1,247)
Allocation of ESOP Stock (17,645 Shares)	—	142	—	350	—	—	492
Balance at September 30, 2015	$ 17,421	$ 249,931	$ 28,791	$ (1,100)	$ (6,520)	$ (77,381)	$ 211,142

[1] Cash dividends paid per share have been adjusted for the September 29, 2016 3.0% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30,	
Cash Flows from Operating Activities:	2016	2015
Net Income	$19,934	$18,093
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	1,550	882
Depreciation and Amortization	4,605	4,844
Allocation of ESOP Stock	510	492
Gains on the Sale of Securities Available-for-Sale	(144)	(106)
Loans Originated and Held-for-Sale	(20,025)	(15,733)
Proceeds from the Sale of Loans Held-for-Sale	19,557	15,615
Net Gains on the Sale of Loans	(649)	(488)
Net Losses on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	120	136
Contributions to Retirement Benefit Plans	(534)	(574)
Deferred Income Tax (Benefit) Expense	(464)	1,242
Shares Issued Under the Directors’ Stock Plan	112	118
Stock-Based Compensation Expense	215	233
Net Increase in Other Assets	(3,045)	(9,134)
Net Increase in Other Liabilities	3,427	4,393
Net Cash Provided By Operating Activities	25,169	20,013
Cash Flows from Investing Activities:		
Proceeds from the Sale of Securities Available-for-Sale	10,568	21,449
Proceeds from the Maturities and Calls of Securities Available-for-Sale	65,965	70,971
Purchases of Securities Available-for-Sale	(10,920)	(124,906)
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	42,295	38,403
Purchases of Securities Held-to-Maturity	(60,786)	(54,796)
Net Increase in Loans	(133,616)	(125,942)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	1,743	997
Purchase of Premises and Equipment	(1,083)	(1,231)
Proceeds from the Sale of a Subsidiary, Net	72	—
Net Decrease (Increase) in Other Investments	3,468	(292)
Net Cash Used By Investing Activities	(82,294)	(175,347)
Cash Flows from Financing Activities:		
Net Increase in Deposits	182,764	179,103
Net Decrease in Short-Term Borrowings	(66,584)	(36,007)
Federal Home Loan Bank Advances	—	45,000
Purchase of Treasury Stock	(1,826)	(1,247)
Stock Options Exercised, Net	1,775	531
Shares Issued Under the Employee Stock Purchase Plan	358	359
Tax Benefit from Exercise of Stock Options	63	31
Shares Issued for Dividend Reinvestment Plans	1,302	439
Cash Dividends Paid	(9,736)	(9,479)
Net Cash Provided By Financing Activities	108,116	178,730

Net Increase in Cash and Cash Equivalents	50,991	23,396
Cash and Cash Equivalents at Beginning of Period	51,068	46,295
Cash and Cash Equivalents at End of Period	$102,059	$69,691
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	$3,932	$3,548
Income Taxes	9,761	8,257
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	856	2,213

See Notes to Unaudited Interim Consolidated Financial Statements.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. ACCOUNTING POLICIES

In the opinion of the management of Arrow Financial Corporation (Arrow), the accompanying unaudited consolidated interim financial statements contain all of the adjustments necessary to present fairly the financial position as of September 30, 2016, December 31, 2015 and September 30, 2015; the results of operations for the three-month period ended September 30, 2016; the consolidated statements of comprehensive income for the three- and nine-month periods ended September 30, 2016; the changes in stockholders' equity for the nine-month periods ended September 30, 2016 and 2015; and the cash flows for the nine-month periods ended September 30, 2016 and 2015. All such adjustments are of a normal recurring nature. Certain prior period amounts have been reclassified to conform to the current presentation. The preparation of financial statements requires the use of management estimates. The unaudited consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements of Arrow for the year ended December 31, 2015, included in Arrow's 2015 Form 10-K.

New Accounting Standards Updates (ASU): During 2016, through the date of this report, the FASB issued 15 accounting standards updates. Some of the standards listed below did not have an immediate impact on Arrow, but could in the future.

ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities" will significantly change the income statement impact of equity investments. For Arrow, the standard is effective for the first quarter of 2018, and will require that equity investments be measured at fair value, with changes in fair value measured in net income. As of September 30, 2016 , we hold a $1.1 million cost basis in a small portfolio of equity investments and we do not expect that the adoption of this change in accounting for equity investments will have a material impact on our financial position or the results of operations in periods subsequent to its adoption.

ASU 2016-02 "Leases" will require the recognition of operating leases. For Arrow, the standard becomes effective in the first quarter of 2019. We do not expect that the adoption of this change in accounting for operating leases will have a material impact on our financial position or the results of operations in periods subsequent to its adoption. As of September 30, 2016, we have less than $3.0 million in operating leases.

ASU 2016-09 "Compensation - Stock Compensation" simplifies certain aspects of accounting for share-based payment transactions, including the tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For Arrow, the standard becomes effective in the first quarter of 2017. We do not expect that the adoption of this change in accounting for stock-based compensation will have a material impact on our financial position or the results of operations in periods subsequent to its adoption.

ASU 2016-13 "Financial Instruments - Credit Losses" will change the way we and other financial entities recognize losses on assets measured at amortized costs and change the method for recognizing credit losses on securities available-for-sale. Currently, loan losses are recognized using an "incurred loss" methodology. Under ASU 2016-13, the methodology will change to a current expected loss over the life of the loan. Currently, credit losses on available-for-sale securities reduce the carrying value of the instrument and cannot be reversed. Under ASU 2016-13, the amount of the credit loss is carried as a valuation allowance and can be reversed. For Arrow, the standard is effective for the first quarter of 2020 and early adoption is allowed in 2019. The Company is currently evaluating the impact of the pending adoption of the ASU on its consolidated financial statements. The initial adjustment will not be reported in earnings, but as the cumulative effect of a change in accounting principle.

ASU 2016-15 "Statement of Cash Flows" provides guidance on the classification of eight specific cash flow issues in order to increase consistency in reporting. Currently, GAAP is either unclear or does not include specific guidance on the cash flow issues addressed in this Update. Arrow currently reports the specifically identified cash flow transactions using the appropriate classification as outlined in the Update. For Arrow, the standard becomes effective in the first quarter of 2017. We do not expect that the adoption of this change in classification for financial reporting will have a material impact on our financial position or the results of operations in periods subsequent to its adoption.

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Note 2. INVESTMENT SECURITIES (In Thousands)

The following table is the schedule of Available-For-Sale Securities at September 30, 2016, December 31, 2015 and September 30, 2015:
Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
September 30, 2016						
Available-For-Sale Securities, at Amortized Cost	$ 152,511	$ 31,562	$ 144,598	$ 4,500	$ 1,120	$ 334,291
Available-For-Sale Securities, at Fair Value	153,926	31,628	148,087	4,299	1,250	339,190
Gross Unrealized Gains	1,415	69	3,489	—	130	5,103
Gross Unrealized Losses	—	3	—	201	—	204
Available-For-Sale Securities, Pledged as Collateral						277,832
Maturities of Debt Securities, at Amortized Cost:						
Within One Year	$ —	$ 19,303	$ 10,214	$ 2,000	$ —	$ 31,517
From 1 - 5 Years	152,511	11,191	129,956	1,500	—	295,158
From 5 - 10 Years	—	508	4,370	—	—	4,878
Over 10 Years	—	560	58	1,000	—	1,618
Maturities of Debt Securities, at Fair Value:						
Within One Year	$ —	$ 19,304	$ 10,294	$ 1,999	$ —	$ 31,597
From 1 - 5 Years	153,926	11,256	132,916	1,500	—	299,598
From 5 - 10 Years	—	508	4,814	—	—	5,322
Over 10 Years	—	560	63	800	—	1,423
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$ —	$ 9,237	$ —	$ 1,022	$ —	$ 10,259
12 Months or Longer	—	—	—	1,800	—	1,800
Total	$ —	$ 9,237	$ —	$ 2,822	$ —	$ 12,059
Number of Securities in a Continuous Loss Position	—	1	2	3	—	6
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$ —	$ 3	$ —	$ 1	$ —	$ 4
12 Months or Longer	—	—	—	200	—	200
Total	$ —	$ 3	$ —	$ 201	$ —	$ 204

December 31, 2015						
Available-For-Sale Securities, at Amortized Cost	$ 155,932	$ 52,306	$ 177,376	$ 14,544	$ 1,120	$ 401,278
Available-For-Sale Securities, at Fair Value	155,782	52,408	178,588	14,299	1,232	402,309
Gross Unrealized Gains	264	105	2,236	—	112	2,717
Gross Unrealized Losses	414	3	1,024	245	—	1,686
Available-For-Sale Securities, Pledged as Collateral						310,857

Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$ 76,802	$ 4,289	$ 99,569	$ 3,616	$ —	$ 184,276
12 Months or Longer	—	1,443	903	10,671	—	13,017
Total	$ 76,802	$ 5,732	$ 100,472	$ 14,287	$ —	$ 197,293
Number of Securities in a Continuous Loss Position	21	19	30	19	—	89
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$ 413	$ 2	$ 1,023	$ 2	$ —	$ 1,440
12 Months or Longer	1	1	1	243	—	246
Total	$ 414	$ 3	$ 1,024	$ 245	$ —	$ 1,686
September 30, 2015						
Available-For-Sale Securities, at Amortized Cost	$ 161,253	$ 55,263	$ 158,351	$ 16,871	$ 1,120	$ 392,858
Available-For-Sale Securities, at Fair Value	162,518	55,486	161,637	16,672	1,246	397,559
Gross Unrealized Gains	1,269	223	3,292	12	125	4,921
Gross Unrealized Losses	4	—	6	211	—	221
Available-For-Sale Securities, Pledged as Collateral						348,115
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$ —	$ —	$ —	$ —	$ —	$ —
12 Months or Longer	12,996	406	4,775	7,162	—	25,339
Total	$ 12,996	$ 406	$ 4,775	$ 7,162	$ —	$ 25,339
Number of Securities in a Continuous Loss Position	3	1	1	11	—	16
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$ —	$ —	$ —	$ —	$ —	$ —
12 Months or Longer	4	—	6	211	—	221
Total	$ 4	$ —	$ 6	$ 211	$ —	$ 221

The following table is the schedule of Held-To-Maturity Securities at September 30, 2016, December 31, 2015 and September 30, 2015:

Held-To-Maturity Securities

State and	Mortgage-	Corporate	Total

	Municipal Obligations	Backed Securities - Residential	and Other Debt Securities	Held-To Maturity Securities
September 30, 2016				
Held-To-Maturity Securities, at Amortized Cost	$ 257,255	$ 79,983	$ 1,000	$ 338,238
Held-To-Maturity Securities, at Fair Value	263,897	82,544	1,000	347,441
Gross Unrealized Gains	6,712	2,561	—	9,273
Gross Unrealized Losses	70	—	—	70
Held-To-Maturity Securities, Pledged as Collateral				320,774

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Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
Maturities of Debt Securities, at Amortized Cost:				
Within One Year	$ 35,911	$ —	$ —	$ 35,911
From 1 - 5 Years	87,464	72,422	—	159,886
From 5 - 10 Years	129,891	7,561	—	137,452
Over 10 Years	3,989	—	1,000	4,989
Maturities of Debt Securities, at Fair Value:				
Within One Year	$ 35,966	$ —	$ —	$ 35,966
From 1 - 5 Years	89,979	74,680	—	164,659
From 5 - 10 Years	133,817	7,864	—	141,681
Over 10 Years	4,135	—	1,000	5,135
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$ 11,891	$ —	$ —	$ 11,891
12 Months or Longer	1,172	—	—	1,172
Total	$ 13,063	$ —	$ —	$ 13,063
Number of Securities in a Continuous Loss Position	3	—	—	3
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$ 68	$ —	$ —	$ 68
12 Months or Longer	2	—	—	2
Total	$ 70	$ —	$ —	$ 70
December 31, 2015				
Held-To-Maturity Securities, at Amortized Cost	$ 226,053	$ 93,558	$ 1,000	$ 320,611
Held-To-Maturity Securities, at Fair Value	230,621	94,309	1,000	325,930
Gross Unrealized Gains	4,619	868	—	5,487
Gross Unrealized Losses	51	117	—	168
Held-To-Maturity Securities, Pledged as Collateral				299,767
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$ 2,302	$ 6,000	$ —	$ 8,302
12 Months or Longer	11,764	4,154	—	15,918
Total	$ 14,066	$ 10,154	$ —	$ 24,220

Number of Securities in a Continuous Loss Position	54	8	—	62
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$ 11	$ 93	$ —	$ 104
12 Months or Longer	40	24	—	64
Total	$ 51	$ 117	$ —	$ 168

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Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
September 30, 2015				
Held-To-Maturity Securities, at Amortized Cost	$ 218,502	$ 97,978	$ 1,000	$ 317,480
Held-To-Maturity Securities, at Fair Value	223,050	99,959	1,000	324,009
Gross Unrealized Gains	4,633	1,981	—	6,614
Gross Unrealized Losses	85	—	—	85
Held-To-Maturity Securities, Pledged as Collateral				296,921
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$ —	$ —	$ —	$ —
12 Months or Longer	14,896	—	—	14,896
Total	$ 14,896	$ —	$ —	$ 14,896
Number of Securities in a Continuous Loss Position	51	—	—	51
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$ —	$ —	$ —	$ —
12 Months or Longer	85	—	—	85
Total	$ 85	$ —	$ —	$ 85

In the tables above, maturities of mortgage-backed-securities - residential are included based on their expected average lives. Actual maturities will differ from the table above because issuers may have the right to call or prepay obligations with, or without, prepayment penalties.

In the available-for-sale category at September 30, 2016, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $152.5 million and a fair value of $153.9 million. Mortgage-backed securities - residential consisted of U.S. Government Agency securities with an amortized cost of $10.8 million and a fair value of $11.0 million and government sponsored entity (GSE) securities with an amortized cost of $133.7 million and a fair value of $137.1 million. In the held-to-maturity category at September 30, 2016, mortgage-backed securities-residential consisted of U.S Government Agency securities with an amortized cost of $3.5 million and a fair value of $3.6 million and GSE securities with an amortized cost of $76.5 million and a fair value of $78.9 million.

In the available-for-sale category at December 31, 2015, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $155.9 million and a fair value of $155.8 million. Mortgage-backed securities - residential consisted of U.S. Government Agency securities with an amortized cost of $15.7 million and a fair value of $15.8 million and GSE securities with an amortized cost of $161.7 million and a fair value of $162.7 million. In the held-to-maturity category at December 31, 2015, mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of $3.8 million and a fair value of $3.9 million and GSE securities with an amortized cost of $89.8 million and a fair value of $90.5 million.

In the available-for-sale category at September 30, 2015, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $161.3 million and a fair value of $162.5 million. Mortgage-backed securities - residential consisted of US Government Agency securities with an amortized cost of $27.5 million and a fair value of $28.1 million and GSE securities with an amortized cost of $130.8 million and a fair value of $133.5 million. In the held-to-maturity category at September 30, 2015, mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of $27.8 million and a fair value of $28.4 million and GSE securities with an amortized cost of $70.2 million and a fair value of $71.5 million.

Securities in a continuous loss position, in the tables above for September 30, 2016, December 31, 2015 and September 30, 2015, do not reflect any deterioration of the credit worthiness of the issuing entities. U.S. Agency issues, including agency-backed collateralized mortgage obligations and mortgage-backed securities, are all rated at least Aaa by Moody's or AA+ by Standard and Poor's. The state and municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, credit analysis is performed in-house based upon data that has been submitted by the issuers to the NY State Comptroller. That analysis reflects satisfactory credit worthiness of the municipalities. Corporate and other debt securities continue to be rated above investment grade according to Moody's and Standard and Poor's. Subsequent to September 30, 2016, and through the date of filing this report, there were no securities downgraded below investment grade.

The unrealized losses on these temporarily impaired securities are primarily the result of changes in interest rates for fixed rate securities where the interest rate received is less than the current rate available for new offerings of similar securities, changes in market spreads as a result of shifts in supply and demand, and/or changes in the level of prepayments for mortgage related securities. Because we do not currently intend to sell any of our temporarily impaired securities, and because it is not more likely-than-not that we would be required to sell the securities prior to recovery, the impairment is considered temporary.

Note 3. LOANS (In Thousands)

Loan Categories and Past Due Loans

The following table presents loan balances outstanding as of September 30, 2016, December 31, 2015 and September 30, 2015 and an analysis of the recorded investment in loans that are past due at these dates. Generally, Arrow considers an amortizing loan past due 30 or more days when the borrower is two payments past due. Loans held-for-sale of $1,414, $298 and $1,004 as of September 30, 2016, December 31, 2015 and September 30, 2015, respectively, are included in the residential real estate balances for current loans.

	Commercial	Commercial Real Estate	Consumer	Residential	Total
September 30, 2016					
Loans Past Due 30-59 Days	$ 38	$ —	$ 3,793	$ 271	$ 4,102
Loans Past Due 60-89 Days	67	—	1,412	1,450	2,929
Loans Past Due 90 or more Days	160	1,106	343	1,467	3,076
Total Loans Past Due	265	1,106	5,548	3,188	10,107
Current Loans	102,789	427,905	518,155	648,260	1,697,109
Total Loans	$ 103,054	$ 429,011	$ 523,703	$ 651,448	$ 1,707,216
Loans 90 or More Days Past Due and Still Accruing Interest	$ —	$ —	$—	$ 548	$ 548
Nonaccrual Loans	160	3,689	532	1,726	6,107
December 31, 2015					
Loans Past Due 30-59 Days	$ 98	$ —	$ 4,598	$ 955	$ 5,651
Loans Past Due 60-89 Days	186	—	1,647	1,370	3,203
Loans Past Due 90 or more Days	203	1,469	295	2,184	4,151
Total Loans Past Due	487	1,469	6,540	4,509	13,005
Current Loans	102,100	383,470	457,983	617,394	1,560,947
Total Loans	$ 102,587	$ 384,939	$ 464,523	$ 621,903	$ 1,573,952
Loans 90 or More Days Past Due and Still Accruing Interest	$ —	$ —	$—	$ 187	$ 187
Nonaccrual Loans	387	2,401	450	3,195	6,433
September 30, 2015					
Loans Past Due 30-59 Days	$ 47	$ —	$ 4,258	$ 427	$ 4,732
Loans Past Due 60-89 Days	68	—	1,234	658	1,960
Loans Past Due 90 or more Days	371	1,817	350	2,909	5,447
Total Loans Past Due	486	1,817	5,842	3,994	12,139
Current Loans	102,403	371,855	453,078	597,450	1,524,786
Total Loans	$ 102,889	$ 373,672	$ 458,920	$ 601,444	$ 1,536,925
Loans 90 or More Days Past Due and Still Accruing Interest	$ —	$ —	$ 1	$ 962	$ 963
Nonaccrual Loans	466	2,752	439	4,134	7,791

The Company disaggregates its loan portfolio into the following four categories:

Commercial - The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable and generally have a lower liquidation value than real estate. In the event of default by the borrower, the Company may be required to liquidate collateral at deeply discounted values. To reduce the risk, management usually obtains personal guarantees of the borrowers.

Commercial Real Estate - The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and both owner- and non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings, and are generally originated in amounts of no more than 80% of the appraised value of the property. However, the Company also offers commercial construction and land development loans to finance projects, primarily within the communities that we serve. Many projects will ultimately be used by the borrowers' businesses, while others are developed for resale. These real estate loans are also secured by first liens on the real estate, which may include apartments, commercial structures, housing business, healthcare facilities and both owner-occupied and non-owner-occupied facilities. There is enhanced risk during the construction period, since the loan is secured by an incomplete project.

Consumer Loans - The Company offers a variety of consumer installment loans to finance personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to five years, based upon the nature of the collateral and the size of the loan. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. Several loans are unsecured, which carry a higher risk of loss. Also included in this category are automobile loans. The Company primarily finances the purchases of automobiles indirectly through dealer relationships located throughout upstate New York and Vermont. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to seven years. Indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Residential Real Estate Mortgages - Residential real estate loans consist primarily of loans secured by first or second mortgages on primary residences. We originate adjustable-rate and fixed-rate one-to-four-family residential real estate loans for the construction, purchase or refinancing of an existing mortgage. These loans are collateralized primarily by owner-occupied properties generally located in the Company’s market area. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower), or have private mortgage insurance. The Company’s underwriting analysis for residential mortgage loans typically includes credit verification, independent appraisals, and a review of the borrower’s financial condition. Mortgage title insurance and hazard insurance are normally required. It is our general practice to underwrite our residential real estate loans to secondary market standards. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period. In addition, the Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Our policy allows for a maximum loan to value ratio of 80%, although periodically higher advances are allowed. The Company originates home equity lines of credit and second mortgage loans (loans secured by a second junior lien position on one-to-four-family residential real estate). Risk is generally reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Allowance for Loan Losses

The following table presents a roll-forward of the allowance for loan losses and other information pertaining to the allowance for loan losses:

Allowance for Loan Losses

	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
Roll-forward of the Allowance for Loan Losses for the Quarterly Periods:						

June 30, 2016	$ 1,128	$ 5,816	$ 5,742	$ 4,026	$ 86	$ 16,798
Charge-offs	(34)	—	(243)	(90)	—	(367)
Recoveries	5	—	59	—	—	64
Provision	(76)	(75)	513	166	(48)	480
September 30, 2016	$ 1,023	$ 5,741	$ 6,071	$ 4,102	$ 38	$ 16,975
June 30, 2015	$ 1,815	$ 3,932	$ 5,416	$ 3,699	$ 712	$ 15,574
Charge-offs	(15)	—	(150)	(215)	—	(380)
Recoveries	5	—	38	—	—	43
Provision	16	100	225	311	(115)	537
September 30, 2015	$ 1,821	$ 4,032	$ 5,529	$ 3,795	$ 597	$ 15,774

Allowance for Loan Losses

	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
Roll-forward of the Allowance for Loan Losses for the Year-to-Date Periods:						
December 31, 2015	$ 1,827	$ 4,520	$ 5,554	$ 3,790	$ 347	$ 16,038
Charge-offs	(86)	—	(591)	(107)	—	(784)
Recoveries	20	—	150	1	—	171
Provision	(738)	1,221	958	418	(309)	1,550
September 30, 2016	$ 1,023	$ 5,741	$ 6,071	$ 4,102	$ 38	$ 16,975
December 31, 2014	$ 2,100	$ 4,128	$ 5,210	$ 3,369	$ 763	$ 15,570
Charge-offs	(46)	—	(483)	(306)	—	(835)
Recoveries	23	—	134	—	—	157
Provision	(256)	(96)	668	732	(166)	882
September 30, 2015	$ 1,821	$ 4,032	$ 5,529	$ 3,795	$ 597	$ 15,774
September 30, 2016						
Allowance for loan losses - Loans Individually Evaluated for Impairment	$ —	$ 240	$ —	$ —	$ —	$ 240
Allowance for loan losses - Loans Collectively Evaluated for Impairment	1,023	5,501	6,071	4,102	38	16,735
Ending Loan Balance - Individually Evaluated for Impairment	—	3,538	90	317	—	3,945
Ending Loan Balance - Collectively Evaluated for Impairment	$ 103,054	$ 425,473	$ 523,613	$ 651,131	$ —	$ 1,703,271
December 31, 2015				—		
Allowance for loan losses - Loans Individually Evaluated for Impairment	$ —	$ —	$ —	$ —	$ —	$ —
Allowance for loan losses - Loans Collectively Evaluated for Impairment	1,827	4,520	5,554	3,790	347	16,038
Ending Loan Balance - Individually Evaluated for Impairment	155	2,372	114	645	—	3,286
Ending Loan Balance - Collectively Evaluated for Impairment	$ 102,432	$ 382,567	$ 464,409	$ 621,258	$ —	$ 1,570,666
September 30, 2015						
Allowance for loan losses - Loans Individually Evaluated for Impairment	$ —	$ —	$ —	$ 135	$ —	$ 135
Allowance for loan losses - Loans Collectively Evaluated for Impairment	1,821	4,032	5,529	3,660	597	15,639
Ending Loan Balance - Individually Evaluated for Impairment	164	2,371	130	1,511	—	4,176
Ending Loan Balance - Collectively Evaluated for Impairment	$ 102,725	$ 371,301	$ 458,790	$ 599,933	$ —	$ 1,532,749

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Through the provision for loan losses, an allowance for loan losses is maintained that reflects our best estimate of the inherent risk of loss in the Company's loan portfolio as of the balance sheet date. Additions are made to the allowance for loan losses through a periodic provision for loan losses. Actual loan losses are charged against the allowance for loan losses when loans are deemed uncollectible and recoveries of amounts previously charged off are recorded as credits to the allowance for loan losses.

Our loan officers and risk managers meet at least quarterly to discuss and review the conditions and risks associated with certain criticized and classified commercial-related relationships. In addition, our independent internal loan review department performs periodic reviews of the risk ratings on individual loans in our commercial loan portfolio.

We use a two-step process to determine the provision for loan losses and the amount of the allowance for loan losses. We measure impairment on our impaired loans on a quarterly basis. Our impaired loans are generally nonaccrual loans over $250 thousand and all troubled debt restructured loans. Our impaired loans are generally considered to be collateral dependent with the specific reserve, if any, determined based on the value of the collateral less estimated costs to sell.

The remainder of the portfolio is evaluated on a pooled basis. For each homogeneous loan pool, we estimate a total loss factor based on the historical net loss rates adjusted for applicable qualitative factors. We update the total loss factors assigned to each loan category on a quarterly basis. For the commercial and commercial real estate categories, we further segregate the loan categories by credit risk profile (pools of loans graded satisfactory, special mention and substandard). Additional description of the credit risk classifications is detailed in the Credit Quality Indicators section of this note.

We determine the annualized historical net loss rate for each loan category using a trailing three-year net charge-off average. While historical net loss experience provides a reasonable starting point for our analysis, historical net losses, or even recent trends in net losses, do not by themselves form a sufficient basis to determine the appropriate level of the allowance for loan losses. Therefore, we also consider and adjust historical net loss factors for qualitative factors that impact the inherent risk of loss associated with our loan categories within our total loan portfolio. These include:

- Changes in the volume and severity of past due, nonaccrual and adversely classified loans
- Changes in the nature and volume of the portfolio and in the terms of loans
- Changes in the value of the underlying collateral for collateral dependent loans
- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses
- Changes in the quality of the loan review system
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectibility of the portfolio
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio or pool

Further, due to the imprecise nature of the loan loss estimation process, the risk attributes of our loan portfolio may not be fully captured in data related to the determination of loss factors used to determine our analysis of the adequacy of the allowance for loan losses. Management, therefore, has established an unallocated portion within the allowance for loan losses reflecting the imprecision that naturally exists in the allowance for loan loss estimation process. The unallocated allowance for loan losses is not considered a significant component of the overall allowance for loan loss estimation process and has been declining steady over the past few quarters.

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Credit Quality Indicators

The following table presents the credit quality indicators by loan category at September 30, 2016, December 31, 2015 and September 30, 2015:

Loan Credit Quality Indicators

	Commercial	Commercial Real Estate	Consumer	Residential	Total
September 30, 2016					
Credit Risk Profile by Creditworthiness Category:					
Satisfactory	$ 93,903	$ 392,697			$486,600
Special Mention	1,274	10,472			11,746
Substandard	7,877	25,842			33,719
Doubtful	—	—			—
Credit Risk Profile Based on Payment Activity:					
Performing			$523,171	$649,093	$1,172,264
Nonperforming			532	2,355	2,887
December 31, 2015					
Credit Risk Profile by Creditworthiness Category:					
Satisfactory	$ 93,607	$ 360,654			$454,261
Special Mention	1,070	4,901			5,971
Substandard	7,910	19,384			27,294
Doubtful	—	—			—
Credit Risk Profile Based on Payment Activity:					
Performing			$464,074	$618,521	$1,082,595
Nonperforming			449	3,382	3,831
September 30, 2015					
Credit Risk Profile by Creditworthiness Category:					
Satisfactory	$ 92,896	$ 350,070			$442,966
Special Mention	1,157	5,170			6,327
Substandard	8,836	18,432			27,268
Doubtful	—	—			—
Credit Risk Profile Based on Payment Activity:					
Performing			$458,479	$596,348	$1,054,827
Nonperforming			441	5,096	5,537

We use an internally developed system of five credit quality indicators to rate the credit worthiness of each commercial loan defined as follows: 1) Satisfactory - "Satisfactory" borrowers have acceptable financial condition with satisfactory record of earnings and sufficient historical and projected cash flow to service the debt. Borrowers have satisfactory repayment histories and primary and secondary sources of repayment can be clearly identified; 2) Special Mention - Loans in this category have potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution’s credit position at some future date. "Special mention" assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Loans which might be assigned this risk rating include loans to borrowers with deteriorating financial strength and/or earnings record and loans with potential for problems due to weakening economic or market conditions; 3) Substandard - Loans classified as “substandard” are inadequately protected by the current sound net worth or paying capacity of the borrower or the collateral pledged, if any. Loans in this category have well defined weaknesses that jeopardize the repayment. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. “Substandard” loans may include loans which are likely to require liquidation of collateral to effect repayment, and other loans where character or ability to repay has become suspect. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard; 4) Doubtful - Loans classified as “doubtful” have all of the weaknesses inherent in those classified as “substandard” with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, conditions, and values highly questionable and improbable. Although possibility of loss is extremely high, classification of these loans as “loss” has been deferred due to specific pending factors or events which may strengthen the value (i.e. possibility of additional collateral, injection of capital, collateral liquidation, debt restructure, economic recovery, etc). Loans classified as “doubtful” need to be placed on

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non-accrual; and 5) Loss - Loans classified as “loss” are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. As of the date of the balance sheet, all loans in this category have been charged-off to the allowance for loan losses. Large commercial loans are evaluated on an annual basis, unless the credit quality indicator falls to a level of "special mention" or below, when the loan is evaluated quarterly. The credit quality indicator is one of the factors used to determine any loss, as further described in this footnote.
For the purposes of the table above, nonperforming consumer and residential loans are those loans on nonaccrual status or are 90 days or more past due and still accruing interest.

Impaired Loans

The following table presents information on impaired loans based on whether the impaired loan has a recorded related allowance or has no recorded related allowance:
Impaired Loans

	Commercial	Commercial Real Estate	Consumer	Residential	Total
September 30, 2016					
Recorded Investment:					
With No Related Allowance	$ —	$ 898	$ 90	$ 317	$1,305
With a Related Allowance	—	2,640	—	—	2,640
Unpaid Principal Balance:					
With No Related Allowance	—	898	90	317	1,305
With a Related Allowance	—	2,640	—	—	2,640
December 31, 2015					
Recorded Investment:					
With No Related Allowance	$ 155	$ 2,372	$ 114	$ 645	$3,286
With a Related Allowance	—	—	—	—	—
Unpaid Principal Balance:					
With No Related Allowance	155	2,372	144	645	3,316
With a Related Allowance	—	—	—	—	—
September 30, 2015					
Recorded Investment:					
With No Related Allowance	$ 164	$ 2,371	$ 130	$ 926	$3,591
With a Related Allowance	—	—	—	585	585
Unpaid Principal Balance:					
With No Related Allowance	164	2,371	130	926	$3,591
With a Related Allowance	—	—	—	585	585
For the Quarter Ended:					
September 30, 2016					
Average Recorded Balance:					
With No Related Allowance	$ —	$ 1,374	$ 92	$ 479	$1,945
With a Related Allowance	—	2,166	—	—	2,166
Interest Income Recognized:					
With No Related Allowance	—	3	2	—	5
With a Related Allowance	—	—	—	—	—
Cash Basis Income:					
With No Related Allowance	—	—	—	—	—

With a Related Allowance	—	—	—	—	—
September 30, 2015					
Average Recorded Balance:					
With No Related Allowance	$ 313	$ 1,931	$ 112	$ 1,312	$3,668
With a Related Allowance	—	—	—	590	590
Interest Income Recognized:					
With No Related Allowance	2	—	2	1	5
With a Related Allowance	—	—	—	—	—
Cash Basis Income:					
With No Related Allowance	—	—	—	—	—
With a Related Allowance	—	—	—	—	—

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Impaired Loans

	Commercial	Commercial Real Estate	Consumer	Residential	Total
For the Year-To-Date Period Ended:					
September 30, 2016					
Average Recorded Balance:					
With No Related Allowance	$ 78	$ 1,635	$ 102	$ 481	$2,296
With a Related Allowance	—	1,320	—	—	1,320
Interest Income Recognized:					
With No Related Allowance	—	14	4	—	18
With a Related Allowance	—	—	—	—	—
Cash Basis Income:					
With No Related Allowance	—	—	—	—	—
With a Related Allowance	—	—	—	—	—
September 30, 2015					
Average Recorded Balance:					
With No Related Allowance	$ 329	$ 1,932	$ 124	$ 1,302	$3,687
With a Related Allowance	—	—	—	572	572
Interest Income Recognized:					
With No Related Allowance	6	—	4	2	12
With a Related Allowance	—	—	—	—	—
Cash Basis Income:					
With No Related Allowance	—	—	—	—	—
With a Related Allowance	—	—	—	—	—

At September 30, 2016, December 31, 2015 and September 30, 2015, all impaired loans were considered to be collateral dependent and were therefore evaluated for impairment based on the fair value of collateral less estimated cost to sell. Interest income recognized in the table above, represents income earned after the loans became impaired and includes restructured loans in compliance with their modified terms and nonaccrual loans where we have recognized interest income on a cash basis.

Loans Modified in Trouble Debt Restructurings

The following table presents information on loans modified in trouble debt restructurings during the periods indicated. All loans were modified under Arrow's own programs. The principal modification, for all the modifications in the table below, involved payment deferrals.

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Loans Modified in Trouble Debt Restructurings During the Period

	Commercial	Commercial Real Estate	Consumer	Residential	Total
For the Quarter Ended:					
September 30, 2016					
Number of Loans	—	—	1	—	1
Pre-Modification Outstanding Recorded Investment	$ —	$ —	$ 15	$ —	$ 15
Post-Modification Outstanding Recorded Investment	—	—	15	—	15
Subsequent Default, Number of Contracts	—	—	—	—	—
Subsequent Default, Recorded Investment	—	—	—	—	—
September 30, 2015					
Number of Loans	—	1	3	—	4
Pre-Modification Outstanding Recorded Investment	$ —	$ 883	$ 49	$ —	$ 932
Post-Modification Outstanding Recorded Investment	—	883	49	—	932
Subsequent Default, Number of Contracts	—	—	—	—	—
Subsequent Default, Recorded Investment	—	—	—	—	—
For the Year-To-Date Period Ended:					
September 30, 2016					
Number of Loans	—	—	2	—	2
Pre-Modification Outstanding Recorded Investment	$ —	$ —	$ 23	$ —	$ 23
Post-Modification Outstanding Recorded Investment	—	—	23	—	23
Subsequent Default, Number of Contracts	—	—	—	—	—
Subsequent Default, Recorded Investment	—	—	—	—	—
September 30, 2015					
Number of Loans	—	1	4	—	5
Pre-Modification Outstanding Recorded Investment	$ —	$ 883	$ 51	$ —	$ 934
Post-Modification Outstanding Recorded Investment	—	883	51	—	934
Subsequent Default, Number of Contracts	—	—	—	—	—
Subsequent Default, Recorded Investment	—	—	—	—	—

In general, loans requiring modification are restructured to accommodate the projected cashflows of the borrower. No loans modified during the preceding twelve months subsequently defaulted as of September 30, 2016.

Note 4. GUARANTEES (In Thousands)

The following table presents the balance for standby letters of credit for the periods ended September 30, 2016, December 31, 2015 and September 30, 2015:

Loan Commitments and Letters of Credit

	September 30, 2016	December 31, 2015	September 30, 2015
Notional Amount:			
Commitments to Extend Credit	$ 300,439	$ 278,623	$ 293,728
Standby Letters of Credit	3,483	3,065	3,201
Fair Value:			
Commitments to Extend Credit	$ —	$ —	$ —
Standby Letters of Credit	31	2	10

Arrow is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit include home equity lines of credit, commitments for residential and commercial construction loans and other personal and commercial lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of the involvement Arrow has in particular classes of financial instruments.

Arrow'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 is represented by the contractual notional amount of those instruments. Arrow uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

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. Arrow evaluates each customer's creditworthiness on a case-by-case basis. Home equity lines of credit are secured by residential real estate. Construction commitments are secured by underlying real estate. For other lines of credit, the amount of collateral obtained, if deemed necessary by Arrow upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. Most of the commitments are variable rate instruments.

Arrow has issued conditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit at September 30, 2016, December 31, 2015 and September 30, 2015 represent the maximum potential future payments Arrow could be required to make. Typically, these instruments have terms of 12 months or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance sheet instruments. Company policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios generally range from 50% for movable assets, such as inventory, to 100% for liquid assets, such as bank CD's. Fees for standby letters of credit typically range from 1% to 3% of the notional amount. Fees are collected upfront and are amortized over the life of the commitment. The fair values of Arrow's standby letters of credit at September 30, 2016, December 31, 2015 and September 30, 2015, in the table above, were the same as the carrying amounts. The fair value of standby letters of credit is based on the fees currently charged for similar agreements or the cost to terminate the arrangement with the counterparties.

The fair value of commitments to extend credit is determined by estimating the fees to enter into similar agreements, taking into account the remaining terms and present creditworthiness of the counterparties, and for fixed rate loan commitments, the difference between the current and committed interest rates. Arrow provides several types of commercial lines of credit and standby letters of credit to its commercial customers. The pricing of these services is not isolated, as Arrow considers the customer's complete deposit and borrowing relationship in pricing individual products and services. The commitments to extend credit also include commitments under home equity lines of credit, for which Arrow charges no fee. The carrying value and fair value of commitments to extend credit are not material and Arrow does not expect to incur any material loss as a result of these commitments.

Note 5. COMPREHENSIVE INCOME (In Thousands)

The following table presents the components of other comprehensive income for the three- and nine-month periods ended September 30, 2016 and 2015:

Schedule of Comprehensive Income

	Three Months Ended September 30,			Nine Months Ended September 30,		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
2016						
Net Unrealized Securities Holding (Losses) Gains Arising During the Period	$(1,264)	$ 454	$ (810)	$3,868	$(1,559)	$ 2,309
Reclassification Adjustment for Securities Gains Included in Net Income	—	—	—	(144)	56	(88)
Amortization of Net Retirement Plan Actuarial Loss	181	(70)	111	503	(189)	314
Accretion of Net Retirement Plan Prior Service Credit	(3)	2	(1)	(7)	2	(5)
Other Comprehensive Income	$(1,086)	$ 386	$ (700)	$4,220	$(1,690)	$ 2,530
2015						
Net Unrealized Securities Holding Gains Arising During the Period	$892	$ (349)	$ 543	$631	$(247)	$ 384
Reclassification Adjustment for Securities Losses Included in Net Income	—	—	—	(106)	41	(65)
Amortization of Net Retirement Plan Actuarial Loss	192	(75)	117	579	(227)	352
Accretion of Net Retirement Plan Prior Service Credit	(13)	4	(9)	(41)	16	(25)
Other Comprehensive Income	$1,071	$ (420)	$ 651	$1,063	$(417)	$ 646

The following table presents the changes in accumulated other comprehensive income by component:
Changes in Accumulated Other Comprehensive Income (Loss) by Component [1]

	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Plan Items		
		Net Gain (Loss)	Net Prior Service (Cost) Credit	Total
For the Quarter-To-Date periods ended:				
June 30, 2016	$ 3,660	$(7,690)	$(712)	$(4,742)
Other comprehensive income or loss before reclassifications	(810)	—	—	(810)
Amounts reclassified from accumulated other comprehensive income	—	111	(1)	110
Net current-period other comprehensive income	(810)	111	(1)	(700)
September 30, 2016	$ 2,850	$(7,579)	$(713)	$(5,442)
June 30, 2015	$ 2,315	$(9,020)	$(466)	$(7,171)
Other comprehensive income or loss before reclassifications	543	—	—	543
Amounts reclassified from accumulated other comprehensive income	—	117	(9)	108
Net current-period other comprehensive income	543	117	(9)	651
September 30, 2015	$ 2,858	$(8,903)	$(475)	$(6,520)
For the Year-To-Date periods ended:				
December 31, 2015	$ 629	$(7,893)	$(708)	$(7,972)
Other comprehensive income or loss before reclassifications	2,309	—	—	2,309
Amounts reclassified from accumulated other comprehensive income	(88)	314	(5)	221
Net current-period other comprehensive income	2,221	314	(5)	2,530
September 30, 2016	$ 2,850	$(7,579)	$(713)	$(5,442)
December 31, 2014	$ 2,539	$(9,255)	$(450)	$(7,166)
Other comprehensive income or loss before reclassifications	384	—	—	384
Amounts reclassified from accumulated other comprehensive income	(65)	352	(25)	262
Net current-period other comprehensive income	319	352	(25)	646
September 30, 2015	$ 2,858	$(8,903)	$(475)	$(6,520)

(1) All amounts are net of tax. Amounts in parentheses indicate debits.

The following table presents the reclassifications out of accumulated other comprehensive income:
Reclassifications Out of Accumulated Other Comprehensive Income [1]

Details about Accumulated Other Comprehensive Income (Loss) Components	Amounts Reclassified from Accumulated Other Comprehensive Income		Affected Line Item in the Statement Where Net Income Is Presented
For the Quarter-to-date periods ended:			
September 30, 2016			
Unrealized gains and losses on available-for-sale securities	$ —		Gain on Securities Transactions
	—		Total before Tax
	—		Provision for Income Taxes
	$ —		Net of Tax
Amortization of defined benefit pension items:			
Prior-service costs	$ 3	[2]	Salaries and Employee Benefits
Actuarial gains/(losses)	(181)	[2]	Salaries and Employee Benefits
	(178)		Total before Tax
	68		Provision for Income Taxes
	$ (110)		Net of Tax
Total reclassifications for the period	$ (110)		Net of Tax
September 30, 2015			
Unrealized gains and losses on available-for-sale securities	$ —		Gain on Securities Transactions
	—		Total before Tax
	—		Provision for Income Taxes
	$ —		Net of Tax
Amortization of defined benefit pension items:			
Prior-service costs	$ 13	[2]	Salaries and Employee Benefits
Actuarial gains/(losses)	(192)	[2]	Salaries and Employee Benefits
	(179)		Total before Tax
	71		Provision for Income Taxes
	$ (108)		Net of Tax
Total reclassifications for the period	$ (108)		Net of Tax

Reclassifications Out of Accumulated Other Comprehensive Income [1]

Details about Accumulated Other Comprehensive Income (Loss) Components	Amounts Reclassified from Accumulated Other Comprehensive Income		Affected Line Item in the Statement Where Net Income Is Presented
For the Year-to-date periods ended:			
September 30, 2016			
Unrealized gains and losses on available-for-sale securities	$ 144		Gain on Securities Transactions
	144		Total before Tax
	(56)		Provision for Income Taxes
	$ 88		Net of Tax
Amortization of defined benefit pension items:			
Prior-service costs	$ 7	[2]	Salaries and Employee Benefits
Actuarial gains/(losses)	(503)	[2]	Salaries and Employee Benefits
	(496)		Total before Tax
	187		Provision for Income Taxes
	$ (309)		Net of Tax
Total reclassifications for the period	$ (221)		Net of Tax
September 30, 2015			
Unrealized gains and losses on available-for-sale securities	$ 106		Gain on Securities Transactions
	106		Total before Tax
	(41)		Provision for Income Taxes
	$ 65		Net of Tax
Amortization of defined benefit pension items:			
Prior-service costs	41	[2]	Salaries and Employee Benefits
Actuarial gains/(losses)	$ (579)	[2]	Salaries and Employee Benefits
	(538)		Total before Tax
	211		Provision for Income Taxes
	$ (327)		Net of Tax
Total reclassifications for the period	$ (262)		Net of Tax

(1) Amounts in parentheses indicate debits to profit/loss.
(2) These accumulated other comprehensive income components are included in the computation of net periodic pension cost.

Note 6. STOCK BASED COMPENSATION PLANS

Under our 2013 Long-Term Incentive Plan, we granted options in the first quarter of 2016 to purchase shares of our common stock. The fair values of the options were estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of our grants is expensed over the four year vesting period.
The following table presents a roll-forward of our stock option plans and grants issued during 2016:
Schedule of Share-based Compensation Arrangements

	Stock Option Plans	
Roll-Forward of Shares Outstanding:		
Outstanding at January 1, 2016	421,751	
Granted	56,650	
Exercised	(82,790)	
Forfeited	(10,758)	
Outstanding at September 30, 2016	384,853	
Exercisable at Period-End	253,241	
Vested and Expected to Vest	131,612	
Roll-Forward of Shares Outstanding - Weighted Average Exercise Price:		
Outstanding at January 1, 2016	$21.93	
Granted	25.10	
Exercised	21.46	
Forfeited	23.97	
Outstanding at September 30, 2016	22.44	
Exercisable at Period-End	21.41	
Vested and Expected to Vest	24.44	
Grants Issued During 2016 - Weighted Average Information:		
Fair Value	$5.60	
Fair Value Assumptions:		
Dividend Yield	3.88	%
Expected Volatility	32.95	%
Risk Free Interest Rate	1.80	%
Expected Lives (in years)	7.56	

The following table presents information on the amounts expensed for the periods ended September 30, 2016 and 2015:
Share-Based Compensation Expense

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Share-Based Compensation Expense	$ 71	$ 76	$215	$233

Arrow also sponsors an Employee Stock Purchase Plan under which employees purchase Arrow's common stock at a 5% discount below market price. Under current accounting guidance, a stock purchase plan with a discount of 5% or less is not considered a compensatory plan.

Note 7. RETIREMENT PLANS (Dollars in Thousands)

The following tables provide the components of net periodic benefit costs for the three- and nine-month periods ended 9/30/2016 and 2015.

	Employees' Pension Plan	Select Executive Retirement Plan	Postretirement Benefit Plans
Net Periodic Benefit Cost			
For the Three Months Ended September 30, 2016:			
Service Cost	$ 376	$ 8	$ 63
Interest Cost	420	56	83
Expected Return on Plan Assets	(828)	—	—
Amortization of Prior Service (Credit) Cost	(14)	14	(3)
Amortization of Net Loss	140	28	—
Net Periodic Benefit Cost	$ 94	$ 106	$ 143
Plan Contributions During the Period	$ —	$ 131	$ 47
For the Three Months Ended September 30, 2015:			
Service Cost	$ 353	$ 3	$ 43
Interest Cost	402	61	144
Expected Return on Plan Assets	(808)	—	—
Amortization of Prior Service (Credit) Cost	(21)	15	(8)
Amortization of Net Loss	139	30	24
Net Periodic Benefit Cost	$ 65	$ 109	$ 203
Plan Contributions During the Period	$ 3,000	$ 70	$ 106
Net Periodic Benefit Cost			
For the Nine Months Ended September 30, 2016:			
Service Cost	$ 1,127	$ 24	$ 188
Interest Cost	1,262	163	178
Expected Return on Plan Assets	(2,483)	—	—
Amortization of Prior Service Cost (Credit)	(42)	43	(8)
Amortization of Net Loss	419	84	—
Net Periodic Benefit Cost	$ 283	$ 314	$ 358
Plan Contributions During the Period	$ —	$ 350	$ 197
Estimated Future Contributions in the Current Fiscal Year	$ —	$ 117	$ 66
For the Nine Months Ended September 30, 2015:			
Service Cost	$ 1,058	$ 8	$ 130
Interest Cost	1,203	182	361
Expected Return on Plan Assets	(2,423)	—	—
Amortization of Prior Service (Credit) Cost	(62)	44	(23)
Amortization of Net Loss	417	91	71
Net Periodic Benefit Cost	$ 193	$ 325	$ 539

Plan Contributions During the Period	$ 3,000	$ 344	$ 231

We were not required to make a contribution to our qualified pension plan in 2016, and currently, we do not expect to make additional contributions in 2016. Arrow makes contributions to its other post-retirement benefit plans in an amount equal to benefit payments for the year.

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Note 8. EARNINGS PER COMMON SHARE (In Thousands, Except Per Share Amounts)

The following table presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted earnings per common share ("EPS") for periods ended September 30, 2016 and 2015. All share and per share amounts have been adjusted for the September 29, 2016 3% stock dividend.

Earnings Per Share

	Quarterly Period Ended:		Year-to-Date Period Ended:	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Earnings Per Share - Basic:				
Net Income	$6,738	$ 5,933	$19,934	$ 18,093
Weighted Average Shares - Basic	13,407	13,275	13,374	13,273
Earnings Per Share - Basic	$0.50	$ 0.45	$1.49	$ 1.36
Earnings Per Share - Diluted:				
Net Income	$6,738	$ 5,933	$19,934	$ 18,093
Weighted Average Shares - Basic	13,407	13,275	13,374	13,273
Dilutive Average Shares Attributable to Stock Options	90	42	65	41
Weighted Average Shares - Diluted	13,497	13,317	13,439	13,314
Earnings Per Share - Diluted	$0.50	$ 0.45	$1.48	$ 1.36
Antidilutive Shares Excluded from the Calculation of Earnings Per Share	—	—	—	—

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Note 9. FAIR VALUE OF FINANCIAL INSTRUMENTS (In Thousands)

FASB ASC Subtopic 820-10 defines fair value, establishes a framework for measuring fair value in Generally Accepted Accounting Principles (GAAP) and requires certain disclosures about fair value measurements. We do not have any nonfinancial assets or liabilities measured at fair value on a recurring basis. The only assets or liabilities that Arrow measured at fair value on a recurring basis at September 30, 2016, December 31, 2015 and September 30, 2015 were securities available-for-sale. Arrow held no securities or liabilities for trading on such dates.
The table below presents the financial instrument's fair value and the amounts within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement:
Fair Value of Assets and Liabilities Measured on a Recurring and Nonrecurring Basis

		Fair Value Measurements at Reporting Date Using:			
	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Fair Value of Assets and Liabilities Measured on a Recurring Basis:					
September 30, 2016					
Securities Available-for Sale:					
U.S. Agency Obligations	$153,926	$—	$153,926	$ —	
State and Municipal Obligations	31,628	—	31,628	—	
Mortgage-Backed Securities - Residential	148,087	—	148,087	—	
Corporate and Other Debt Securities	4,299	—	4,299	—	
Mutual Funds and Equity Securities	1,250	—	1,250	—	
Total Securities Available-for-Sale	$339,190	$—	$339,190	$ —	
December 31, 2015					
Securities Available-for Sale:					
U.S. Agency Obligations	$155,782	$—	$155,782	$ —	
State and Municipal Obligations	52,408	—	52,408	—	
Mortgage-Backed Securities - Residential	178,588	—	178,588	—	
Corporate and Other Debt Securities	14,299	—	14,299	—	
Mutual Funds and Equity Securities	1,232	—	1,232	—	
Total Securities Available-for Sale	$402,309	$—	$402,309	$ —	
September 30, 2015					
Securities Available-for Sale:					
U.S. Agency Obligations	$162,518	$—	$162,518	$ —	
State and Municipal Obligations	55,486	—	55,486	—	
Mortgage-Backed Securities - Residential	161,637	—	161,637	—	
Corporate and Other Debt Securities	16,672	—	16,672	—	
Mutual Funds and Equity Securities	1,246	—	1,246	—	
Total Securities Available-for Sale	$397,559	$—	$397,559	$ —	

Fair Value of Assets and Liabilities Measured on a Nonrecurring Basis:				
September 30, 2016				
Collateral Dependent Impaired Loans	$2,640	$— $—	$ 2,640	$ (240)
Other Real Estate Owned and Repossessed Assets, Net	1,016	——	1,016	(319)
December 31, 2015				
Collateral Dependent Impaired Loans	$—	$— $—	$ —	$ —
Other Real Estate Owned and Repossessed Assets, Net	2,018	——	2,018	(687)
September 30, 2015				
Collateral Dependent Impaired Loans	$902	$— $—	$ 902	$ (322)
Other Real Estate Owned and Repossessed Assets, Net	585	——	585	(135)

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We determine the fair value of financial instruments under the following hierarchy:

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

Fair Value Methodology for Assets and Liabilities Measured on a Recurring Basis

The fair value of Level 1 securities available-for-sale are based on unadjusted, quoted market prices from exchanges in active markets. The fair value of Level 2 securities available-for-sale are based on an independent bond and equity pricing service for identical assets or significantly similar securities and an independent equity pricing service for equity securities not actively traded. The pricing service uses a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Fair Value Methodology for Assets and Liabilities Measured on a Nonrecurring Basis

The fair value of collateral dependent impaired loans was based on third-party appraisals of the collateral. The fair value of other real estate owned was based on third-party appraisals. Other assets which might have been included in this table include mortgage servicing rights, goodwill and other intangible assets. Arrow evaluates each of these assets for impairment on a quarterly basis, with no impairment recognized for these assets at September 30, 2016, December 31, 2015 and September 30, 2015.

Fair Value by Balance Sheet Grouping

The following table presents a summary of the carrying amount, the fair value or an amount approximating fair value and the fair value hierarchy of Arrow's financial instruments:

Schedule of Fair Values by Balance Sheet Grouping

			Fair Value Hierarchy		
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
September 30, 2016					
Cash and Cash Equivalents	$102,059	$102,059	$102,059	$ —	$ —
Securities Available-for-Sale	339,190	339,190	—	339,190	—
Securities Held-to-Maturity	338,238	347,441	—	347,441	—
Federal Home Loan Bank and Federal Reserve Bank Stock	5,371	5,371	5,371	—	—
Net Loans	1,690,241	1,696,929	—	—	1,696,929
Accrued Interest Receivable	7,046	7,046	7,046	—	—
Deposits	2,213,187	2,207,985	2,004,182	203,803	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	38,589	38,589	38,589	—	—
Federal Home Loan Bank Overnight Advances	—	—	—	—	—
Federal Home Loan Bank Term Advances	55,000	55,955	—	55,955	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	247	247	247	—	—
December 31, 2015					
Cash and Cash Equivalents	$51,068	$51,068	$51,068	$ —	$ —
Securities Available-for-Sale	402,309	402,309	—	402,309	—
Securities Held-to-Maturity	320,611	325,930	—	325,930	—
Federal Home Loan Bank and Federal Reserve Bank Stock	8,839	8,839	8,839	—	—
Net Loans	1,557,914	1,557,511	—	—	1,557,511
Accrued Interest Receivable	6,360	6,360	6,360	—	—
Deposits	2,030,423	2,024,224	1,840,606	183,618	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	23,173	19,421	19,421	—	—
Federal Home Loan Bank Overnight Advances	82,000	82,000	82,000	—	—
Federal Home Loan Bank Term Advances	55,000	55,063	—	55,063	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	231	231	231	—	—
September 30, 2015					
Cash and Cash Equivalents	$69,691	$69,691	$69,691	$ —	$ —
Securities Available-for-Sale	397,559	397,559	—	397,559	—
Securities Held-to-Maturity	317,480	324,009	—	324,009	—
Federal Home Loan Bank and Federal Reserve Bank Stock	5,143	5,143	5,143	—	—
Net Loans	1,521,151	1,530,930	—	—	1,530,930
Accrued Interest Receivable	6,949	6,949	6,949	—	—
Deposits	2,082,051	2,076,658	1,887,237	189,421	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	24,414	24,414	24,414	—	—

Federal Home Loan Bank Overnight Advances	—	—	—	—	—
Federal Home Loan Bank Term Advances	55,000	56,630	—	56,630	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	306	306	306	—	—

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Fair Value Methodology for Financial Instruments Not Measured on a Recurring or Nonrecurring Basis

Securities held-to-maturity are fair valued utilizing an independent bond pricing service for identical assets or significantly similar securities. The pricing service uses a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Fair values for loans are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial real estate, residential mortgage, indirect and other consumer loans. Each loan category is further segmented into fixed and adjustable interest rate terms and by performing and nonperforming categories. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions. Fair value for nonperforming loans is generally based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discount rates are judgmentally determined using available market information and specific borrower information.

The fair value of time deposits is based on the discounted value of contractual cash flows, except that the fair value is limited to the extent that the customer could redeem the certificate after imposition of a premature withdrawal penalty. The discount rates are estimated using the FHLBNY yield curve, which is considered representative of Arrow’s time deposit rates. The fair value of all other deposits is equal to the carrying value.

The fair value of FHLBNY advances is estimated based on the discounted value of contractual cash flows. The discount rate is estimated using current rates on FHLBNY advances with similar maturities and call features.

Based on Arrow’s capital adequacy, the book value of the outstanding trust preferred securities (Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts) are considered to approximate fair value since the interest rates are variable (indexed to LIBOR) and Arrow is well-capitalized.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Arrow Financial Corporation:

We have reviewed the consolidated balance sheets of Arrow Financial Corporation and subsidiaries (the Company) as of September 30, 2016 and 2015, the related consolidated statements of income, comprehensive income for the three-month and nine-month periods ended September 30, 2016 and 2015, and related consolidated statements of changes in stockholders' equity and cash flows for the nine-month periods ended September 30, 2016 and 2015. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Arrow Financial Corporation and subsidiaries as of December 31, 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 10, 2016, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2015, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP
Albany, New York
November 8, 2016

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
September 30, 2016

Note on Terminology - In this Quarterly Report on Form 10-Q, the terms “Arrow,” “the registrant,” “the company,” “we,” “us, and “our” generally refer to Arrow Financial Corporation and its subsidiaries as a group, except where the context indicates otherwise.

The Company and Its Subsidiaries - Arrow is a two-bank holding company headquartered in Glens Falls, New York. Our banking subsidiaries are Glens Falls National Bank and Trust Company (Glens Falls National) whose main office is located in Glens Falls, New York, and Saratoga National Bank and Trust Company (Saratoga National) whose main office is located in Saratoga Springs, New York. Our non-bank subsidiaries include Capital Financial Group, Inc. (an insurance agency specializing in selling and servicing group health care policies); two property and casualty insurance agencies: Upstate Agency LLC and McPhillips Agency (which is a division of Glens Falls National Insurance Agencies LLC); North Country Investment Advisers, Inc. (a registered investment adviser that provides investment advice to our proprietary mutual funds); Glens Falls National Community Development Corporation (which invests in qualifying community development projects); and Arrow Properties, Inc. (a real estate investment trust, or REIT). All of these are wholly-owned or majority owned subsidiaries of Glens Falls National.

Our Peer Group - At certain points in this Report, our performance is compared with that of our “peer group” of financial institutions. Unless otherwise specifically stated, the peer group for the purposes of this Form 10-Q is comprised of the group of 338 domestic bank holding companies with $1 to $3 billion in total consolidated assets as identified in the Federal Reserve Board’s “Bank Holding Company Performance Report” for June 30, 2016 (the most recent such Report currently available), and peer group data contained herein has been derived from such Report.
Forward Looking Statements - This Quarterly Report on Form 10-Q contains statements that are not historical in nature but rather are based on our beliefs, assumptions, expectations, estimates and projections about the future. These statements are “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and involve a degree of uncertainty and attendant risk. Words such as “expects,” “believes,” “anticipates,” “estimates” and variations of such words and similar expressions are intended to identify such forward-looking statements. Some of these statements, such as those included in the interest rate sensitivity analysis in Part I, Item 3, entitled “Quantitative and Qualitative Disclosures About Market Risk,” are merely presentations of what future performance or changes in future performance would look like based on hypothetical assumptions and on simulation models. Other forward-looking statements are based on our general perceptions of market conditions and trends in business activity, both our own and in the banking industry generally, as well as current management strategies for future operations and development.
Examples of Forward-Looking Statements:

Topic	Page	Location
Future compliance with regulatory capital standards	43	1st paragraph under "Regulatory Capital and Increase in Stockholders' Equity"
VISA	44	"VISA Class B Common Stock"
Impact of market rate structure on net interest margin, loan yields and deposit rates	49	1st and 3rd paragraphs under "Quarterly Taxable Equivalent Yield on Loans"
Impact of market rate structure on net interest margin, loan yields and deposit rates	63	Last paragraph under "Quantitative and Qualitative Disclosures about Market Risk
Future level of residential real estate loans	48	2nd paragraph under "Residential Real Estate Loans"
Future level of indirect consumer loans	49	Last paragraph under "Consumer Loans"
Future level of commercial loans	48	3rd paragraph under "Commercial Loans,and Commercial Real Estate Loans"

Impact of changes in mortgage rates	51	Paragraph under "Investment Sales, Purchases and Maturities"
Provision for loan losses	52	1st paragraph in section
Future level of nonperforming assets	53	Last 3 paragraphs under "Risk Elements"
Liquidity	56	2nd paragraph under "LIQUIDITY"
Fees for other services to customers	58, 61	3rd paragraph under "Noninterest Income"

Forward-looking statements contained herein are not guarantees of future performance and involve certain risks and uncertainties that are difficult to quantify or, in some cases, to identify. In the case of all such forward-looking statements, actual outcomes and results may differ materially from what the statements predict or forecast. Factors that could cause or contribute to such differences include, but are not limited to:

a. rapid and dramatic changes in economic and market conditions;
b. sharp fluctuations in interest rates, economic activity, and consumer spending patterns;
c. network attacks or unauthorized access to computer systems and network infrastructure, interruptions of service and other security risks, whether company-specific, industry-specific or regional or nationwide;
d. sudden changes in the market for products we provide, such as real estate loans;
e. significant new banking laws and regulations, including rules still to be issued under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act or Dodd-Frank);

f. unexpected or enhanced competition from new or unforeseen sources, whether company-specific or industry-specific ; and

g. similar uncertainties inherent in banking operations such as ours, the financial world, or governmental finance generally, including periodic heightened concerns about U.S. or state governmental budgets, deficits, spending and taxes.

Readers are cautioned not to place undue reliance on forward-looking statements in this Report, which speak only as of the date hereof. We undertake no general obligation to revise or update these forward-looking statements to reflect the occurrence of unanticipated events. This Quarterly Report should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015.

USE OF NON-GAAP FINANCIAL MEASURES

In May 2016, the SEC issued an updated interpretative release relating to Regulation G. Regulation G is a rule that was initially adopted by the Securities and Exchange Commission (SEC) in 2003, which establishes certain limits and requirements on the use by SEC-registered companies of so-called "non-GAAP financial measures" in their SEC filings and reports, including earnings releases. The May 2016 interpretations primarily address three issues: 1) the continuing use of certain misleading non-GAAP financial measures, particularly with respect to revenue; 2) continuing use of per share non-GAAP measures relating to liquidity, which is not permitted, versus performance, which may be permissible; and 3) inappropriate adjustments for tax expenses.

GAAP is generally accepted accounting principles in the United States of America. Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure (if a comparable GAAP measure exists) and a statement of the Company’s reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. The SEC has exempted from the definition of “non-GAAP financial measures” certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. One such exempt non-GAAP measure is regulatory capital. Financial institutions like the Company and its subsidiary banks must calculate and report their condition under an array of bank regulatory capital measures that are financial in nature but are not based on GAAP and are not easily reconcilable to the closest comparable GAAP financial measures, even in those cases where a comparable measure exists. The Company follows industry practice in disclosing its financial condition under these various regulatory capital measures, including period-end regulatory capital ratios for itself and its subsidiary banks, in its periodic reports filed with the SEC, including this Report, and does so without compliance with Regulation G, on the widely-shared understanding that the SEC regards bank regulatory capital measures to be exempt from Regulation G.

In addition to regulatory capital measures, the Company uses in preparing its financial statements several additional non-GAAP financial measures that are commonly utilized by financial institutions but have not been specifically exempted by the SEC from Regulation G and may not be exempt. Some of the more significant non-GAAP measures generally included by the Company in its public filings with the SEC are identified and described below, with a brief explanation for the Company's usage of such measures if and when they are in fact included in filed reports. Some of these non-GAAP measures are included in this Report, including in the tables on pages 37 and 39 and the notes on pages 38 and 40. Where any such non-GAAP measure is used in this Report, and a comparable GAAP measure exists, the tabular presentation of the GAAP measure precedes presentation of the non-GAAP measure and a reconciliation of the non-GAAP measure to the GAAP measure is set forth in proximity to, or cross-referenced from, the non-GAAP measure.

Tax-Equivalent Net Interest Income and Net Interest Margin: Net interest income, as a component of the tabular presentation by financial institutions of Selected Financial Information regarding their recently completed operations, as well as narrative disclosures based on that tabular presentation, is often presented on a tax-equivalent basis, i.e., on a non-GAAP basis. That is, to the extent that some component of the institution's net interest income, which is presented on a before-tax basis, is exempt from taxation (e.g., is received by the institution as a result of its holdings of state or municipal obligations), an amount equal to the tax benefit derived from that component is added to the actual before-tax net interest income total to generate tax-equivalent net interest income. This adjustment is considered helpful in comparing one financial institution's net interest income to that of another institution or in analyzing any institution’s net interest income trend line over time, to correct any analytical distortion that might otherwise arise from the fact that financial institutions vary widely in the proportions of their portfolios that are invested in tax-exempt securities, and that even a single institution may significantly alter over time the proportion of its own portfolio that is invested in tax-exempt obligations. Moreover, net interest income is itself a component of a second financial measure commonly used by financial institutions (and included in Selected Financial Information tables), i.e., net interest margin, which is the ratio of net interest income to average earning assets. For purposes of calculating this measure, financial institutions that present net interest income on a tax-equivalent basis typically use that same measure, a non-GAAP measure, in calculating their net interest margin (which also becomes a non-GAAP measure, again to provide a better basis of comparison from institution to institution and to better demonstrate a single institution’s performance over time. We follow these practices.

The Efficiency Ratio: Financial institutions often use an "efficiency ratio" as a measure of expense control. It is not a GAAP measure and no reasonably comparable GAAP measure exists. The efficiency ratio (a financial measure as to which lower is better) typically is defined as the ratio of noninterest expense to net interest income and noninterest income. Net interest income as utilized in calculating the efficiency ratio is typically the same as the net interest income presented in Selected Financial Information table discussed in the preceding paragraph, i.e., it is expressed on a tax-equivalent basis. Moreover, most financial institutions, in calculating the efficiency ratio, also adjust both noninterest expense and noninterest income to exclude from these items (as calculated under GAAP) certain recurring component elements of income and expense, such as intangible asset amortization (deducted from noninterest expense) and securities gains or losses (excluded from noninterest income). We follow these practices.

Tangible Book Value per Share: Tangible equity, a non-GAAP measure, is total stockholders’ equity less intangible assets. Tangible book value per share is tangible equity divided by total shares issued and outstanding. Tangible book value per share is often regarded as a more meaningful comparative ratio than book value per share as calculated under GAAP, that is, total stockholders’ equity including intangible assets divided by total shares issued and outstanding. Intangible assets under GAAP include many items, but in our case, essentially represent goodwill.

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Adjustments for Certain Items of Income or Expense: When we believe the circumstances so warrant, we occasionally include in our presentation and discussion of our financial results, in addition to the required GAAP and GAAP-based disclosures (e.g., net income, earnings per share, return on average assets, return on average equity and other GAAP-based financial measures), comparative disclosures that adjust one or more of these, GAAP financial measures by removing therefrom the impact of certain non recurring transactions or other one-time material items of income or expense. When we include such disclosures, it is because we believe that the resulting non-GAAP financial measures may improve an understanding of our results of operations by separating out items that have a disproportionate positive or negative impact on such results for the particular period in question, or where we believe the adjustment for certain items allows a better comparison from period-to-period in our results of operations with respect to our fundamental lines of business including the commercial banking business. We believe that our presentation of such non-GAAP financial measures from time-to-time may be useful to investors and the market in evaluating our performance. Any such information should be considered as supplemental in nature and not as a substitute for or superior to the related financial information prepared in accordance with GAAP.

Arrow Financial Corporation
Selected Quarterly Information
(Dollars In Thousands, Except Per Share Amounts - Unaudited)

Quarter Ended	9/30/2016	6/30/2016	3/31/2016	12/31/2015	9/30/2015
Net Income	$6,738	$6,647	$6,549	$6,569	$5,933
Transactions Recorded in Net Income (Net of Tax):					
Net Gain on Securities Transactions	—	88	—	14	—
Share and Per Share Data:[1]					
Period End Shares Outstanding	13,426	13,388	13,361	13,328	13,292
Basic Average Shares Outstanding	13,407	13,372	13,343	13,306	13,275
Diluted Average Shares Outstanding	13,497	13,429	13,379	13,368	13,317
Basic Earnings Per Share	$0.50	$0.50	$0.49	$0.49	$0.45
Diluted Earnings Per Share	0.50	0.49	0.49	0.49	0.45
Cash Dividend Per Share	0.243	0.243	0.24	0.243	0.238
Selected Quarterly Average Balances:					
Interest-Bearing Deposits at Banks	21,635	22,195	21,166	44,603	17,788
Investment Securities	696,712	701,526	716,523	716,947	711,830
Loans	1,680,850	1,649,401	1,595,018	1,556,234	1,502,620
Deposits	2,063,832	2,082,449	2,069,964	2,075,825	1,970,738
Other Borrowed Funds	209,946	165,853	143,274	127,471	148,887
Shareholders' Equity	228,048	223,234	218,307	213,219	209,334
Total Assets	2,528,124	2,496,795	2,456,431	2,442,964	2,356,121
Return on Average Assets, annualized	1.06 %	1.07 %	1.07 %	1.07 %	1.00 %
Return on Average Equity, annualized	11.75 %	11.98 %	12.07 %	12.22 %	11.24 %
Return on Tangible Equity, annualized (Non-GAAP) [2] [2]	13.18 %	13.47 %	13.62 %	13.86 %	12.79 %
Average Earning Assets	2,399,197	2,373,122	2,332,707	2,317,784	2,232,238
Average Paying Liabilities	1,892,583	1,891,017	1,867,455	1,854,549	1,772,156
Interest Income, Tax-Equivalent (Non-GAAP) [3]	20,403	20,343	19,745	19,619	18,924
Interest Expense	1,405	1,284	1,263	1,231	1,253
Net Interest Income, Tax-Equivalent (Non-GAAP) [3] [3] (Non-GAAP)	18,998	19,059	18,482	18,388	17,671
Tax-Equivalent Adjustment (Non-GAAP) [3]	1,121	1,106	1,119	1,109	1,093
Net Interest Margin, annualized (Non-GAAP) [3]	3.15 %	3.23 %	3.19 %	3.15 %	3.14 %
Efficiency Ratio Calculation: (Non-GAAP) [4]					
Noninterest Expense	$15,082	$14,884	$14,370	$14,242	$14,850
Less: Intangible Asset Amortization	74	74	75	78	79
Net Noninterest Expense	15,008	14,810	14,295	14,164	14,771
	18,998	19,059	18,482	18,388	17,671

Net Interest Income, Tax-Equivalent (Non-GAAP) [3]					
Noninterest Income	7,114	7,194	6,875	6,687	7,137
Less: Net Securities Gain	—	144	—	23	—
Net Gross Income	26,112	26,109	25,357	25,052	24,808
Efficiency Ratio (Non-GAAP)	57.48 %	56.72 %	56.37 %	56.54 %	59.54 %
Period-End Capital Information:					
Total Stockholders' Equity (i.e. Book Value)	$229,208	$225,373	$220,703	$213,971	$211,142
Book Value per Share [1]	17.07	16.83	16.52	16.05	15.88
Goodwill and Other Intangible Assets, net	24,675	24,758	24,872	24,980	25,266
Tangible Book Value per Share (Non-GAAP) [1,2]	15.23	14.98	14.66	14.18	13.98
Capital Ratios:[5]					
Tier 1 Leverage Ratio	9.44 %	9.37 %	9.36 %	9.25%	9.40%
Common Equity Tier 1 Capital Ratio	12.80 %	12.74 %	12.84 %	12.82%	12.66%
Tier 1 Risk-Based Capital Ratio	13.98 %	13.95 %	14.08 %	14.08%	13.93%
Total Risk-Based Capital Ratio	14.99 %	14.96 %	15.09 %	15.09%	14.94%
Assets Under Trust Administration and Investment Management	$1,284,051	$1,250,770	$1,231,237	$1,232,890	$1,195,629

Arrow Financial Corporation
Selected Quarterly Information - Continued
(Dollars In Thousands, Except Per Share Amounts - Unaudited)

Footnotes:

1. Share and Per Share Data have been restated for the September 29, 2016, 3% stock dividend.

2. Tangible Book Value, Tangible Equity and Return on Tangible Equity exclude goodwill and other intangible assets, net from total equity. These are non-GAAP financial measures which we believe provide investors with information that is useful in understanding our financial performance. See "Use of Non-GAAP Financial Measures" on page 35.

	9/30/2016	6/30/2016	3/31/2016	12/31/2015	9/30/2015
Total Stockholders' Equity (GAAP)	$229,208	$225,373	$220,703	$213,971	$211,142
Less: Goodwill and Other Intangible assets, net	24,675	24,758	24,872	24,980	25,266
Tangible Equity (Non-GAAP)	$204,533	$200,615	$195,831	$188,991	$185,876
Period End Shares Outstanding	13,426	13,388	13,361	13,328	13,292
Tangible Book Value per Share (Non-GAAP)	$15.23	$14.98	$14.66	$14.18	$13.98
Net Income	6,738	6,647	6,549	6,569	5,933
Return on Tangible Equity (Net Income/Tangible Equity - Annualized)	13.18 %	13.47 %	13.62 %	13.86 %	12.79 %

3. Net Interest Margin is the ratio of our annualized tax-equivalent net interest income to average earning assets. This is also a non-GAAP financial measure which we believe provides investors with information that is useful in understanding our financial performance. See "Use of Non-GAAP Financial Measures" on page 35.

	9/30/2016	6/30/2016	3/31/2016	12/31/2015	9/30/2015
Interest Income (GAAP)	$19,282	$19,237	$18,626	$18,510	$17,831
Add: Tax-Equivalent adjustment (Non-GAAP)	1,121	1,106	1,119	1,109	1,093
Interest Income - Tax Equivalent (Non-GAAP)	$20,403	$20,343	$19,745	$19,619	$18,924
Net Interest Income (GAAP)	$17,877	$17,953	$17,363	$17,279	$16,578
Add: Tax-Equivalent adjustment (Non-GAAP)	1,121	1,106	1,119	1,109	1,093
Net Interest Income - Tax Equivalent (Non-GAAP)	$18,998	$19,059	$18,482	$18,388	$17,671
Average Earning Assets	$2,399,197	$2,373,122	$2,332,707	$2,317,784	$2,232,238
Net Interest Margin (Non-GAAP)*	3.15 %	3.23 %	3.19 %	3.15 %	3.14 %

4. Financial Institutions often use the "efficiency ratio", a non-GAAP ratio, as a measure of expense control. We believe the efficiency ratio provides investors with information that is useful in understanding our financial performance. We define our efficiency ratio as the ratio of our noninterest expense to our net gross income (which equals our tax-equivalent net interest income plus noninterest income, as adjusted). See "Use of Non-GAAP Financial Measures" on page 35.

5. For the recently-completed quarter, all of the regulatory capital ratios in the table on page 37 and the table in this Note 5, below, as well as the Total Risk-Weighted Assets and Common Equity Tier 1 Capital amounts listed in the

table below, are estimates based on, and calculated in accordance with, bank regulatory capital rules. The Common Equity Tier 1 Capital Ratio (CET1 Ratio) of Arrow as of 9/30/2016 that is listed in the tables (i.e., 12.80%) not only exceeds the currently required minimum CET1 Ratio of 5.125%, but also exceeds the minimum CET1 Ratio that will be required when the Capital Conservation Buffer is fully phased-in, on January 1, 2019, of 7.00% (including the ultimate required Capital Conservation Buffer of 2.50%).

	9/30/2016	6/30/2016	3/31/2016	12/31/2015	9/30/2015
Total Risk Weighted Assets	$1,690,646	$1,662,381	$1,617,957	$1,590,129	$1,574,704
Common Equity Tier 1 Capital	216,382	211,801	207,777	203,848	199,377
Common Equity Tier 1 Capital Ratio	12.80 %	12.74 %	12.84 %	12.82 %	12.66 %

* Quarterly ratios have been annualized

Arrow Financial Corporation
Selected Year-to-Date Information
(Dollars In Thousands, Except Per Share Amounts - Unaudited)

Nine Months Ended	9/30/2016	9/30/2015
Net Income	$19,934	$18,093
Transactions Recorded in Net Income (Net of Tax):		
Net Gain on Securities Transactions	88	64
Share and Per Share Data:[1]		
Period End Shares Outstanding	13,426	13,292
Basic Average Shares Outstanding	13,374	13,273
Diluted Average Shares Outstanding	13,439	13,314
Basic Earnings Per Share	$1.49	$1.36
Diluted Earnings Per Share	1.48	1.36
Cash Dividend Per Share	0.73	0.71
Selected Year-to-Date Average Balances:		
Interest-Bearing Deposits at Banks	21,665	28,504
Investment Securities	704,890	695,777
Loans	1,641,899	1,460,681
Deposits	2,072,052	1,968,132
Other Borrowed Funds	173,159	106,264
Shareholders’ Equity	223,214	206,263
Total Assets	2,493,909	2,307,263
Return on Average Assets, annualized	1.07 %	1.05 %
Return on Average Equity, annualized	11.93 %	11.73 %
Return on Tangible Equity, annualized (Non-GAAP) [2]	13.42 %	13.38 %
Average Earning Assets	2,368,454	2,184,962
Average Paying Liabilities	1,883,717	1,752,028
Interest Income, Tax-Equivalent (Non-GAAP) [3]	60,491	55,498
Interest Expense	3,952	3,582
Net Interest Income, Tax-Equivalent (Non-GAAP) [3]	56,539	51,916
Tax-Equivalent Adjustment (Non-GAAP) [3]	3,346	3,270
Net Interest Margin, annualized (Non-GAAP) [3]	3.19 %	3.18 %
Efficiency Ratio Calculation: [4]		
Noninterest Expense	44,337	43,188
Less: Intangible Asset Amortization	223	250
Net Noninterest Expense	44,114	42,938
Net Interest Income, Tax-Equivalent (Non-GAAP) [3]	56,539	51,916
Noninterest Income	21,184	21,437
Less: Net Securities Gain	144	106
Net Gross Income	77,579	73,247
Efficiency Ratio (Non-GAAP)	56.86 %	58.62 %

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Arrow Financial Corporation
Selected Year-to-Date Information - Continued
(Dollars In Thousands, Except Per Share Amounts - Unaudited)

Footnotes:

1. Share and Per Share Data have been restated for the September 29, 2016, 3% stock dividend.

2. Tangible Book Value, Tangible Equity and Return on Tangible Equity exclude goodwill and other intangible assets, net from total equity. These are non-GAAP financial measures which we believe provide investors with information that is useful in understanding our financial performance. See "Use of Non-GAAP Financial Measures" on page 35.

	9/30/2016	9/30/2015
Total Stockholders' Equity (GAAP)	$229,208	$211,142
Less: Goodwill and Other Intangible assets, net	24,675	25,266
Tangible Equity (Non-GAAP)	$204,533	$185,876
Period End Shares Outstanding	13,426	13,292
Tangible Book Value per Share (Non-GAAP)	$15.23	$13.98
Net Income	19,934	18,093
Return on Tangible Equity (Net Income/Tangible Equity - Annualized)	13.42 %	13.38 %

3. Net Interest Margin is the ratio of our annualized tax-equivalent net interest income to average earning assets. This is also a non-GAAP financial measure which we believe provides investors with information that is useful in understanding our financial performance. See "Use of Non-GAAP Financial Measures" on page 35.

	9/30/2016	9/30/2015
Net Interest Income (GAAP)	$57,145	$52,228
Add: Tax-Equivalent adjustment (Non-GAAP)	$3,346	$3,270
Net Interest Income - Tax Equivalent (Non-GAAP)	$60,491	$55,498
Net Interest Income (GAAP)	$53,193	$48,646
Add: Tax-Equivalent adjustment (Non-GAAP)	3,346	3,270
Net Interest Income - Tax Equivalent (Non-GAAP)	$56,539	$51,916
Average Earning Assets	$2,368,454	$2,184,962
Net Interest Margin (Non-GAAP)*	3.19 %	3.18 %

4. Financial Institutions often use the "efficiency ratio", a non-GAAP ratio, as a measure of expense control. We believe the efficiency ratio provides investors with information that is useful in understanding our financial performance. We define our efficiency ratio as the ratio of our noninterest expense to our net gross income (which equals our tax-equivalent net interest income plus noninterest income, as adjusted). See "Use of Non-GAAP Financial Measures" on page 35.

* Year-to-date ratios have been annualized

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Average Consolidated Balance Sheets and Net Interest Income Analysis
(see “Use of Non-GAAP Financial Measures” on page 35)
(Fully Taxable Basis using a marginal tax rate of 35%)
(Dollars In Thousands)

Quarter Ended September 30:	2016			2015		
	Average Balance	Interest Income/ Expense	Rate Earned/ Paid	Average Balance	Interest Income/ Expense	Rate Earned/ Paid
Interest-Bearing Deposits at Banks	$21,635	$34	0.63 %	$17,788	$13	0.29 %
Investment Securities:						
Fully Taxable	409,355	1,893	1.84	438,651	1,984	1.79
Exempt from Federal Taxes	287,357	2,513	3.48	273,179	2,460	3.57
Loans	1,680,850	15,963	3.78	1,502,620	14,467	3.82
Total Earning Assets	2,399,197	20,403	3.38	2,232,238	18,924	3.36
Allowance for Loan Losses	(16,696)			(15,513)		
Cash and Due From Banks	36,041			31,827		
Other Assets	109,582			107,569		
Total Assets	$2,528,124			$2,356,121		
Deposits:						
NOW Accounts	$869,439	320	0.15	$871,839	292	0.13
Savings Deposits	607,850	231	0.15	556,144	189	0.13
Time Deposits of $100,000 or More	75,388	128	0.68	59,639	89	0.59
Other Time Deposits	129,960	164	0.50	135,647	179	0.52
Total Interest-Bearing Deposits	1,682,637	843	0.20	1,623,269	749	0.18
Short-Term Borrowings	134,946	152	0.45	73,887	55	0.30
FHLBNY Term Advances and Other Long-Term Debt	75,000	410	2.17	75,000	449	2.38
Total Interest-Bearing Liabilities	1,892,583	1,405	0.30	1,772,156	1,253	0.28
Demand Deposits	381,195			347,469		
Other Liabilities	26,298			27,162		
Total Liabilities	2,300,076			2,146,787		
Stockholders’ Equity	228,048			209,334		
Total Liabilities and Stockholders’ Equity	$2,528,124			$2,356,121		
Net Interest Income (Tax-equivalent Basis) (Non-GAAP) [1]		18,998			17,671	
Reversal of Tax Equivalent Adjustment		(1,121)	(0.19)%		(1,093)	(0.19)%
Net Interest Income		$17,877			$16,578	
Net Interest Spread (Non-GAAP) [1]			3.08 %			3.08 %
Net Interest Margin (Non-GAAP) [1]			3.15 %			3.14 %

[1] See Note 3 on p. 40

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Average Consolidated Balance Sheets and Net Interest Income Analysis
(see “Use of Non-GAAP Financial Measures” on page 35)
(Fully Taxable Basis using a marginal tax rate of 35%)
(Dollars In Thousands)

Nine-Month Period Ended September 30:	2016			2015		
	Average Balance	Interest Income/ Expense	Rate Earned/ Paid	Average Balance	Interest Income/ Expense	Rate Earned/ Paid
Interest-Bearing Deposits at Banks	$21,665	$100	0.62 %	$28,504	$60	0.28 %
Investment Securities:						
Fully Taxable	427,937	6,006	1.87	426,148	5,949	1.87
Exempt from Federal Taxes	276,953	7,427	3.58	269,629	7,240	3.59
Loans	1,641,899	46,958	3.82	1,460,681	42,249	3.87
Total Earning Assets	2,368,454	60,491	3.41	2,184,962	55,498	3.40
Allowance for Loan Losses	(16,316)			(15,548)		
Cash and Due From Banks	32,327			31,234		
Other Assets	109,444			106,615		
Total Assets	$2,493,909			$2,307,263		
Deposits:						
NOW Accounts	$909,268	941	0.14	$902,745	960	0.14
Savings Deposits	604,886	677	0.15	544,959	538	0.13
Time Deposits of $100,000 or More	66,230	313	0.63	59,857	267	0.60
Other Time Deposits	130,174	497	0.51	138,203	566	0.55
Total Interest-Bearing Deposits	1,710,558	2,428	0.19	1,645,764	2,331	0.19
Short-Term Borrowings	98,159	303	0.41	43,169	80	0.25
FHLBNY Term Advances and Other Long-Term Debt	75,000	1,221	2.17	63,095	1,171	2.48
Total Interest-Bearing Liabilities	1,883,717	3,952	0.28	1,752,028	3,582	0.27
Demand Deposits	361,494			322,368		
Other Liabilities	25,484			26,604		
Total Liabilities	2,270,695			2,101,000		
Stockholders’ Equity	223,214			206,263		
Total Liabilities and Stockholders’ Equity	$2,493,909			$2,307,263		
Net Interest Income (Tax-equivalent Basis) (Non-GAAP)		56,539			51,916	
Reversal of Tax Equivalent Adjustment		(3,346)	(0.19)%		(3,270)	(0.20)%
Net Interest Income		$53,193			$48,646	
Net Interest Spread (Non-GAAP) [1]			3.13 %			3.13 %
Net Interest Margin (Non-GAAP) [1]			3.19 %			3.18 %

[1] See Note 3 on p. 40

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OVERVIEW

We reported net income for the third quarter of 2016 of $6.7 million, an increase of $805 thousand, or 13.6%, over our net income for the third quarter of 2015. Diluted earnings per share (EPS) for the quarter were $0.50, an increase of $0.05, or 11.1%, from the EPS of $0.45 reported for the third quarter of 2015. Return on average equity (ROE) for the third quarter of 2016 continued to be strong at 11.75%, up from an ROE of 11.24% for the quarter ended September 30, 2015. Return on average assets (ROA) for the 2016 third quarter was 1.06%, an increase from an ROA of 1.00% for the quarter ended September 30, 2015. The increase in net income between the respective periods was largely the result of a significant increase in net interest income, which itself was primarily attributable to an even greater increase in average earning assets, particularly in loans, between the periods. Tax-equivalent net interest income (a non-GAAP measure) increased between the respective quarters by approximately 0.4%, while average earning assets increased by 7.5%. Total loans increased between the respective period ends by $170 million, or 11.1%. Since the third quarter of 2015, we have expanded our smaller subsidiary bank, Saratoga National Bank, deeper into the Capital District, with the opening of a branch location in Rensselaer County. Salaries and employee benefits expenses decreased by 0.1% in the third quarter of 2016 compared to the 2015 quarter, due at least in part to a small decrease in the number of full-time equivalent employees between the periods. Total assets were $2.58 billion at September 30, 2016, which represented an increase of $134.3 million, or 5.5%, from the level at December 31, 2015, and an increase of $160.9 million, or 6.7%, from the September 30, 2015 level.

The changes in net income, net interest income and net interest margin between the three- and nine-month periods are more fully described under the heading "RESULTS OF OPERATIONS," beginning on page 58.

Stockholders’ equity was $229.2 million at September 30, 2016, an increase of $15.2 million, or 7.1%, from the December 31, 2015 level of $214.0 million, and an increase of $18.1 million, or 8.6%, from the prior year level (representing, in each case, a higher rate of growth than the growth in total assets). The components of the change in stockholders’ equity since year-end 2015 are presented in the Consolidated Statement of Changes in Stockholders’ Equity on page 6, and are discussed in more detail in the next section.

Regulatory Capital and Increase in Stockholders' Equity: At September 30, 2016, we exceeded by a substantial amount all required minimum capital ratios under the new bank regulatory capital rules at both the holding company and bank levels. At that date, both of our banks, as well as our holding company, continued to qualify as "well-capitalized" under the recently revised capital classification guidelines that became effective contemporaneously with the new bank regulatory capital rules in 2015. Because of our continued profitability and strong asset quality, our regulatory capital levels throughout recent years have consistently remained well in excess of the various required regulatory minimums in effect from time to time, and are well in excess of the currently required minimum levels, which, as a result of the Dodd-Frank Act, have increased and will continue to increase, as a percentage of assets, each year from 2015 to 2019.

At September 30, 2016, our book value per share was $17.07, up by 7.5% over the year earlier level, and our tangible book value per share (a non-GAAP measure that deducts intangible assets from stockholders' equity) was $15.23, an increase of $1.25, or 8.9%, over the level as of September 30, 2015, and an increase of $1.05, or 7.4%, over the December 31, 2015 level. See the disclosure on page 35 related to our use of non-GAAP financial measures generally, and tangible book value, specifically. In the past nine months, total shareholders' equity increased by 7.1% and our total book value per share increased by 6.4%. The increase in stockholders' equity over the first nine months of 2016 principally reflected the following factors: (i) $19.9 million of net income for the period, (ii) $2.5 million of other comprehensive income for the period, and (iii) issuance of $3.1 million of common stock through our employee benefit and dividend reinvestment plans; reduced by (iii) cash dividends of $9.7 million; and (iv) repurchases of our own common stock, principally in connection with stock-for-stock option exercises, of $1.8 million. As of September 30, 2016, our closing stock price was $32.83, representing a trading multiple of 2.16 to our tangible book value. As adjusted for a 3.0% stock dividend distributed September 29, 2016, the Company paid a quarterly cash dividend of $0.238 per share for each of the first three quarters of 2015, and a cash dividend of $0.243 per share for the last quarter of 2015 and the first three quarters of 2016.

Loan Quality: Our net charge-offs for the third quarter of 2016 were $303 thousand as compared to $337 thousand for the comparable 2015 quarter. Our ratio of net charge-offs to average loans (annualized) was 0.07% for the third quarter of 2016 compared to 0.09% for the third quarter of 2015. Our peer group's weighted average ratio of net charge-offs to average loans was 0.07% for the period ended June 30, 2016. See page 34 for a discussion of our peer group. At September 30, 2016, our allowance for loan losses was $17.0 million representing 0.99% of total loans, down 3 basis points from the December 31, 2015 ratio. We believe this allowance is appropriate and reflects the continuing strong credit quality in the loan portfolio.

Nonperforming loans were $6.8 million at September 30, 2016, representing 0.40% of period-end loans, a decrease of 19 basis points from our year-earlier ratio. By way of comparison, the weighted average ratio for our peer group was 0.84% at June 30, 2016, considerably better (lower) than the peer group's ratios at earlier year-ends but still considerably higher than ours on such date. Our ratio has remained quite low and stable from 2008 through the date of this Report.

Loan Growth: During the first nine months of 2016, we experienced increases in outstanding balances in each of the largest segments of our loan portfolio, without any significant deterioration in our credit quality.

Commercial Loans: These loans comprised 6.0% of our loan portfolio at period-end, and the balance was up slightly (by 0.5%), over the year-end 2015 balance. The business sector in our service area, including small- and mid-sized business with headquarters in the area, continued to be in reasonably good financial condition at period-end, and some lines of business appear to be experiencing modest improvement during the year.

Commercial Real Estate Loans: Commercial property values in our region have remained stable in recent periods, although it should be noted such values did not show significant deterioration even in the worst phases of the financial crisis. We update

the appraisals on our nonperforming and watched CRE loan properties as deemed necessary, usually when the loan is downgraded or when we perceive significant market deterioration since our last appraisal. CRE loans comprised 25.1% of our loan portfolio at period-end; the period-end balance of such loans was up significantly (by 11.4%) over the year-end 2015 balance.
Consumer Loans: These loans (primarily automobile loans) comprised 30.7% of our loan portfolio at period-end; the balance of these loans also was up significantly (by 12.7%) over the year-end level. Consumer automobile loans at September 30, 2016, were $516 million, or 98.6% of this portfolio segment. In the first nine months of 2016, we did not experience any significant increase in our delinquency rate or in the percentage of nonperforming loans in this segment. Employment in our service area continues to expand modestly, and unemployment rates remain low, well off their post-crisis levels.
Residential Real Estate Loans: These loans, including home equity loans, made up 38.2% of our portfolio at period-end, and the balance was up, if only modestly (by 4.8%), over the year-end 2015 balance. The residential real estate market in our service area has been stable in recent periods. During the worst of the financial crisis, we did not experience a notable increase in our foreclosure or loss rates on our residential real estate loans, nor have we in ensuing periods, primarily due to the fact that we have never originated or participated in underwriting high-risk mortgage loans. During 2015 and 2016 refinancings of our own loans represented about 15% of our total originations. If long-term interest rates, which decreased during the second quarter of 2016 before rebounding modestly during the third quarter, do not increase significantly above their period-end levels, we may continue to experience a modest volume of mortgage refinancings. We originated nearly all of the residential real estate loans currently held in our portfolio and apply conservative underwriting standards to our originations. We typically sell a portion, sometimes a significant portion, of our residential real estate mortgage originations to the secondary market, although our sales of originations as a portion of our total originations have diminished somewhat in recent periods.

Liquidity and Access to Credit Markets: We have not experienced any liquidity problems or special concerns thus far in 2016, nor did we in any prior years the back to and during the financial crisis. The terms of our lines of credit with our correspondent banks, the FHLBNY and the Federal Reserve Bank have not changed significantly in recent periods (see our general liquidity discussion on page 56). Historically, we have principally relied on asset-based liquidity (i.e., funds in overnight investments and cash flow from maturing investments and loans) with liability-based liquidity as a secondary source of funds (our main liability-based sources are overnight borrowing arrangements with our correspondent banks, an arrangement for overnight borrowing and term credit advances from the FHLBNY, and an additional arrangement for short-term advances at the Federal Reserve Bank discount window). We regularly perform a liquidity stress test and periodically test our contingent liquidity plan to ensure that we can generate an adequate amount of available funds to meet a wide variety of potential liquidity crises, including a severe crisis.

Visa Class B Common Stock: Our banks, as former member banks of Visa, continue to bear some indirect contingent liability to various third parties who may have certain claims against Visa, including class action claims, to the extent that Visa's direct liabilities resulting from such claims ultimately may exceed the amounts held in a litigation escrow account set up by Visa several years ago to defray such liabilities, using funds which would otherwise have been owed by it to its member banks in redemption of their Class B Visa shares. In July 2012, Visa and MasterCard entered into a Memorandum of Understanding ("MOU") with a class of plaintiffs to settle certain covered antitrust claims against the two card companies involving merchant discounts. In December 2013, a federal judge gave final approval to the class settlement agreement in this litigation. The total cash settlement payment was set at approximately $6.05 billion, of which Visa’s share represented approximately $4.4 billion. Visa has paid its portion of this settlement from the litigation escrow account. However, approximately one hundred merchants have filed a challenge to the settlement based on claims of attorney misconduct causing some uncertainty with respect to the finalization of the settlement. Previously, in the second quarter 2012, in light of the state of covered litigation at Visa at the time and the substantial dollar amount in the litigation escrow fund then remaining , we determined to reverse the entire amount of an earlier VISA litigation-related accrual, which was then $294 thousand pre-tax. This reversal reduced our other operating expenses for the year ending December 31, 2012. We believed then, and continue to believe, that the balance that Visa currently maintains in its litigation escrow account is sufficient to satisfy Visa's remaining direct liability to such claims, if any, without further resort to the contingent liability of the former Visa member banks. At September 30, 2016, the Company held 27,771 shares of Visa Class B common stock and we continue not to recognize any economic value for these shares.

Sale of Loomis & LaPann, Inc.: Effective October 30, 2015, the Company sold 100% of the stock of one of its wholly-owned subsidiary insurance agencies, Loomis & LaPann, Inc. (“Loomis”), to a local insurance agency headquartered in Glens Falls, NY. Historically, Loomis had sold as its featured product sports insurance, which was the line of business the buyer was particularly interested in acquiring, but Loomis had also sold property and casualty insurance. Thus, prior to the sale of Loomis to the buyer, the Company transferred Loomis's property and casualty business to another of the Company’s wholly-owned subsidiary insurance agencies, the McPhillips Agency, such that the sports insurance business was the primary business line sold to the buyer at closing. The right to use the Loomis name was also transferred to the buyer. The Loomis sports insurance business, while we owned it, was very specialized and the vast majority of the related revenue was generated from customers located outside of our service area in New York State. Three Loomis employees who were principally involved in the sports insurance business remained with Loomis as part of the sale. We will receive post-closing cash payments from the buyer through 2018.

CHANGE IN FINANCIAL CONDITION

Summary of Selected Consolidated Balance Sheet Data
(Dollars in Thousands)

At Period-End				$ Change	$ Change	% Change	% Change
September 30, 2016	December 31, 2015	September 30, 2015	&#				