CENTURY BANCORP INC
Form 10-K
March 15, 2019
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 0-15752

CENTURY BANCORP, INC.

(Exact name of registrant as specified in its charter)

COMMONWEALTH OF MASSACHUSETTS	**04-2498617**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification number)*
400 MYSTIC AVENUE, MEDFORD, MA	**02155**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number including area code:

(781) 391-4000

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

Class A Common Stock, $1.00 par value	**Nasdaq Global Market**
(Title of class)	*(Name of Exchange)*

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

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

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulations S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

State the aggregate market value of the registrant s voting and nonvoting stock held by nonaffiliates, computed using the closing price as reported on Nasdaq as of June 30, 2018 was $276,823,482.

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of February 28, 2019:

Class A Common Stock, $1.00 par value 3,608,329 Shares

Class B Common Stock, $1.00 par value 1,959,580 Shares

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980).

(1) Portions of the Registrant s Annual Report to Stockholders for the fiscal year ended December 31, 2018 are incorporated into Part II, Items 5-8 of this Form 10-K.

Table of Contents

CENTURY BANCORP INC.

FORM 10-K

TABLE OF CONTENTS

Table of Contents

PART I

ITEM 1. *BUSINESS*

The Company

Century Bancorp, Inc. (together with its bank subsidiary, unless the context otherwise requires, the Company) is a Massachusetts state-chartered bank holding company headquartered in Medford, Massachusetts. The Company is a Massachusetts corporation formed in 1972 and has one banking subsidiary (the Bank): Century Bank and Trust Company formed in 1969. At December 31, 2018, the Company had total assets of $5.2 billion. Currently, the Company operates 27 banking offices in 20 cities and towns in Massachusetts, ranging from Braintree in the south to Andover in the north. The Bank s customers consist primarily of small and medium-sized businesses and retail customers in these communities and surrounding areas, as well as local governments and large healthcare and higher education institutions throughout Massachusetts, New Hampshire, Rhode Island, Connecticut, and New York.

The Company s results of operations are largely dependent on net interest income, which is the difference between the interest earned on loans and securities and interest paid on deposits and borrowings. The results of operations are also affected by the level of income and fees from loans, deposits, as well as operating expenses, the provision for loan losses, the impact of federal and state income taxes and the relative levels of interest rates and economic activity.

The Company offers a wide range of services to commercial enterprises, state and local governments and agencies, non-profit organizations and individuals. It emphasizes service to small and medium-sized businesses and retail customers in its market area. The Company makes commercial loans, real estate and construction loans and consumer loans, and accepts savings, time, and demand deposits. In addition, the Company offers to its corporate and institutional customers automated lock box collection services, cash management services and account reconciliation services, and actively promotes the marketing of these services to the municipal market. Also, the Company provides full service securities brokerage services through a program called Investment Services at Century Bank, which is supported by LPL Financial, a third party full-service securities brokerage business.

The Company has municipal cash management client engagements in Massachusetts, New Hampshire and Rhode Island comprised of approximately 250 government entities.

Availability of Company Filings

Under the Securities Exchange Act of 1934, Sections 13 and 15(d), periodic and current reports must be filed with the Securities and Exchange Commission (the SEC). The Company electronically files with the SEC its periodic and current reports, as well as other filings it makes with the SEC from time to time. The SEC maintains an Internet site that contains reports and other information regarding issuers, including the Company, that file electronically with the SEC, at www.sec.gov, in which all forms filed electronically may be accessed. Additionally, our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and additional shareholder information are available free of charge on the Company s website: www.centurybank.com.

Employees

As of December 31, 2018, the Company had 403 full-time and 57 part-time employees. The Company s employees are not represented by any collective bargaining unit. The Company believes that its employee relations are good.

Financial Services Modernization

On November 12, 1999, President Clinton signed into law The Gramm-Leach-Bliley Act (Gramm-Leach) which significantly altered banking laws in the United States. Gramm-Leach enables combinations among banks, securities firms and insurance companies beginning March 11, 2000. As a result of Gramm Leach, many of the depression-era laws that restricted these affiliations and other activities that may be engaged in by banks and bank holding companies were repealed. Under Gramm-Leach, bank holding companies are permitted to offer their customers virtually any type of financial service that is financial in nature or incidental thereto, including banking, securities underwriting, insurance (both underwriting and agency) and merchant banking.

In order to engage in these financial activities, a bank holding company must qualify and register with the Federal Reserve Board as a financial holding company by demonstrating that each of its bank subsidiaries is well capitalized, well managed, and has at least a satisfactory rating under the Community Reinvestment Act of 1977 (the CRA). The Company has not elected to become a financial holding company under Gramm-Leach.

These financial activities authorized by Gramm-Leach may also be engaged in by a financial subsidiary of a national or state bank, except for insurance or annuity underwriting, insurance company portfolio investments, real estate investment and development and merchant banking, which must be conducted in a financial holding company. In order for the new financial activities to be engaged in by a financial subsidiary of a national or state bank, Gramm-Leach requires each of the parent bank (and any bank affiliates) to be well capitalized and well managed; the aggregate consolidated assets of all of that bank s financial subsidiaries may not exceed the lesser of 45% of its consolidated total assets or $50 billion; the bank must have at least a satisfactory CRA rating; and, if the bank is one of the 100 largest banks, it must meet certain financial rating or other comparable requirements. The Company does not currently conduct activities through a financial subsidiary.

Gramm-Leach establishes a system of functional regulation, under which the federal banking agencies will regulate the banking activities of financial holding companies and banks financial subsidiaries, the SEC will regulate their securities activities, and state insurance regulators will regulate their insurance activities. Gramm-Leach also provides new protections against the transfer and use by financial institutions of consumers nonpublic, personal information.

Holding Company Regulation

The Company is a bank holding company as defined by the Bank Holding Company Act of 1956, as amended (the Holding Company Act), and is registered as such with the Board of Governors of the Federal Reserve Bank (the FRB), which is responsible for administration of the Holding Company Act. Although the Company may meet the qualifications for electing to become a financial holding company under Gramm-Leach, the Company has elected to retain its pre-Gramm-Leach status for the present time under the Holding Company Act. As required by the Holding Company Act, the Company files with the FRB an annual report regarding its financial condition and operations, management and intercompany relationships of the Company and the Bank. It is also subject to examination by the FRB and must obtain FRB approval before (i) acquiring direct or indirect ownership or control of more than 5% of the voting stock of any bank, unless it already owns or controls a majority of the voting stock of that bank, (ii) acquiring all or substantially all of the assets of a bank, except through a subsidiary which is a bank, or (iii) merging or consolidating with any other bank holding company. A bank holding company must also give the FRB prior written notice before purchasing or redeeming its equity securities, if the gross consideration for the purchase or redemption, when aggregated with the net consideration paid by the company for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the company s consolidated net worth.

The Holding Company Act prohibits a bank holding company, with certain exceptions, from (i) acquiring direct or indirect ownership or control of more than 5% of any class of voting shares of any company which is not a bank or a bank holding company, or (ii) engaging in any activity other than managing or controlling banks, or furnishing services to or performing services for its subsidiaries. A bank holding company may own, however, shares of a company engaged in activities which the FRB has determined are so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The Company and its subsidiaries are examined by federal and state regulators. The FRB has regulatory authority over holding company activities and performed a review of the Company and its subsidiaries as of September 2017.

Table of Contents

USA PATRIOT Act

Under Title III of the USA PATRIOT Act, also known as the International Money Laundering Abatement and Anti-Terrorism Act of 2001, all financial institutions are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Additional information-sharing among financial institutions, regulators, and law enforcement authorities is encouraged by the presence of an exemption from the privacy provisions of the Gramm-Leach Act for financial institutions that comply with this provision and the authorization of the Secretary of the Treasury to adopt rules to further encourage cooperation and information-sharing. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Holding Company Act or Bank Merger Act.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act, signed into law July 30, 2002, addresses, among other issues, corporate governance, auditor independence and accounting standards, executive compensation, insider loans, whistleblower protection and enhanced and timely disclosure of corporate information. The SEC has adopted a substantial number of implementing rules and the Financial Industry Regulatory Authority (FINRA) has adopted corporate governance rules that have been approved by the SEC and are applicable to the Company. The changes are intended to allow stockholders to monitor more effectively the performance of companies and management. As directed by Section 302(a) of the Sarbanes-Oxley Act, the Company s Chief Executive Officer and Chief Financial Officer are each required to certify that the Company s quarterly and annual reports do not contain any untrue statement of a material fact. This requirement has several parts, including certification that these officers are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company s disclosure controls and procedures and internal controls over financial reporting; that they have made certain disclosures to the Company s auditors and the Board of Directors about the Company s disclosure controls and procedures and internal control over financial reporting, and that they have included information in the Company s quarterly and annual reports about their evaluation of the Company s disclosure controls and procedures and internal control over financial reporting, and whether there have been significant changes in the Company s internal disclosure controls and procedures or in other factors that could significantly affect such controls and procedures subsequent to the evaluation and whether there have been any significant changes in the Company s internal control over financial reporting that have materially affected or reasonably likely to materially affect the Company s internal control over financial reporting, and compliance with certain other disclosure objectives. Section 906 of the Sarbanes-Oxley Act requires an additional certification that each periodic report containing financial statements fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934 and that the information in the report fairly presents, in all material respects, the financial conditions and results of operations of the Company.

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the D-F Act) became law. The D-F Act was intended to address many issues arising in the recent financial crisis and is exceedingly broad in scope, affecting many aspects of bank and financial market regulation. The D-F Act requires, or permits by implementing regulation, enhanced prudential standards for banks and bank holding companies inclusive of capital, leverage, liquidity, concentration and exposure measures. In addition, traditional bank regulatory principles such as restrictions on transactions with affiliates and insiders were enhanced. The D-F Act also contains reforms of consumer mortgage lending practices and creates a Bureau of Consumer Financial Protection, which is granted broad authority over consumer financial practices of banks and others. It is expected as the specific new or incremental requirements applicable to the Company become effective that the costs and difficulties of remaining compliant with all such requirements will increase. The D-F Act broadened the base for FDIC assessments to average consolidated assets less tangible equity of financial institutions and also permanently raises the current standard maximum FDIC deposit insurance amount to $250,000. The Act extended unlimited deposit insurance on non-interest bearing transaction accounts through December 31, 2012.

In addition, the D-F Act added a new Section 13 to the Bank Holding Company Act, the so-called Volcker Rule, (the Rule) which generally restricts certain banking entities such as the Company and its subsidiaries or affiliates, from engaging in proprietary trading activities and owning equity in or sponsoring any private equity or hedge fund. The Rule became effective July 21, 2012. The final implementing regulations for the Rule were issued by various regulatory agencies in December, 2013 and under an extended conformance regulation compliance was required to be achieved by July 21, 2015. The conformance period for investments in and relationships with certain legacy covered funds was extended to July 21, 2017. Under the Rule, the Company may be restricted from engaging in proprietary trading, investing in third party hedge or private equity funds or sponsoring new funds unless it qualifies for an exemption from the rule. The Company has little involvement in prohibited proprietary trading or investment activities in covered funds and the Company does not expect that complying with the requirements of the Rule will have any material effect on the Company s financial condition or results of operation. The federal banking agencies have issued notices of proposed rulemaking to make certain amendments to the Rule to simply and tailor compliance requirements and to conform the Rule to the EGRRCPA (discussed below).

Tax Cuts and Jobs Act

On December 22, 2017, the Tax Cuts and Jobs Act (the Tax Act) was enacted, which represents the most comprehensive reform to the U.S. tax code in over thirty years. The majority of the provisions of the Tax Act took effect on January 1, 2018. The Tax Act lowered the Company s federal tax rate from 34% to 21%. Also, for tax years beginning after December 31, 2017, the corporate Alternative Minimum Tax (AMT) has been repealed. For 2018 through 2021, the AMT credit carryforward can offset regular tax liability and is refundable in an amount equal to 50% (100% for 2021) of the excess of the minimum tax credit for the tax year over the amount of the credit allowable for the year against regular tax liability. Accordingly, it is anticipated that the full amount of the alternative minimum tax credit carryforward will be recovered in tax years beginning before 2022. The Tax Act also contains other provisions that may affect the Company currently or in future years. Among these are changes to the deductibility of meals and entertainment, the deductibility of executive compensation, the dividend received deduction and net operating loss carryforwards. Tax Act changes for individuals include lower tax rates, mortgage interest and state and local tax limitations as well as an increase in the standard deduction, among others.

Economic Growth, Regulatory Relief, and Consumer Protection Act

On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act, or the EGRRCPA, became law. This is arguably the most significant financial institution legislation since the D-F Act. The EGRRCPA changes certain of the regulatory requirements of the D-F Act and includes provisions intended to relieve the regulatory burden on community banks. Among other things, for qualifying community banks with less than $10 billion in total consolidated assets, the EGRRCPA contains a safe harbor from the D-F Act ability to repay mortgage requirements, an exemption from the Volcker Rule, may permit filing of simplified Call Reports, and potentially will result in some alleviation of the D-F Act and U.S. Basel III capital mandates. The EGRRCPA requires the federal banking agencies to develop a community bank leverage ratio (defined as the ratio of tangible equity capital to average total consolidated assets) for banks and holding companies with total consolidated assets of less than $10 billion and an appropriate risk profile. The required regulations must specify a minimum community bank leverage ratio of not less than 8% and not more than 10%. The federal banking agencies jointly issued a notice of proposed rulemaking which would set the minimum ratio at 9%. Qualifying banks that exceed the minimum community bank leverage ratio will be deemed to be in compliance with all other capital and leverage requirements including the capital ratio requirements that are required to be considered well capitalized under Section 38 of Federal Deposit Insurance Act.

Deposit Insurance Premiums

The Bank s deposits have the benefit of FDIC insurance up to applicable limits. The FDIC s Deposit Insurance Fund is funded by assessments on insured depository institutions, which depend on the risk category of an institution and the amount of assets that it holds. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis.

Table of Contents

On September 29, 2009, the FDIC adopted a Notice of Proposed Rulemaking (NPR) that required insured institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. The FDIC Board voted to adopt a uniform three-basis point increase in assessment rates effective on January 1, 2011, and extend the restoration period from seven to eight years. This rule was finalized on November 2, 2009. The Company s quarterly risk-based deposit insurance assessments were paid from this amount until June 30, 2013. The Company received a refund of $2.4 million of prepaid FDIC assessments in June 2013.

In February 2011, the FDIC approved a rule to change the assessment base from adjusted domestic deposits to average consolidated total assets minus average tangible equity. The rule has kept the overall amount collected from the industry very close to the amount collected prior to the new calculation.

In December 2018, the FDIC issued a final rule to implement the EGRRCPA providing a limited exception for a capped amount of reciprocal deposits from treatment as brokered deposits for qualifying institutions.

Risk-Based Capital Guidelines

Federal banking regulators have issued risk-based capital guidelines, which assign risk factors to asset categories and off-balance-sheet items. Also, the Basel Committee has issued capital standards entitled Basel III: A global regulatory framework for more resilient banks and banking systems (Basel III). The Federal Reserve Board has finalized its rule implementing the Basel III regulatory capital framework. The rule that came into effect in January 2015 sets the Basel III minimum regulatory capital requirements for all organizations. It included a new common equity Tier I ratio of 4.5 percent of risk-weighted assets, raised the minimum Tier I capital ratio from 4 percent to 6 percent of risk-weighted assets and would set a new conservation buffer of 2.5 percent of risk-weighted assets. The implementation of the framework did not have a material impact on the Company s financial condition or results of operations.

Competition

The Company experiences substantial competition in attracting deposits and making loans from commercial banks, thrift institutions and other enterprises such as insurance companies and mutual funds. These competitors include several major commercial banks whose greater resources may afford them a competitive advantage by enabling them to maintain numerous branch offices and mount extensive advertising campaigns. A number of these competitors are not subject to the regulatory oversight that the Company is subject to, which increases these competitors flexibility.

Forward-Looking Statements

Certain statements contained herein are not based on historical facts and are forward-looking statements within the meaning of Section 21A of the Securities Exchange Act of 1934. Forward-looking statements, which are based on various assumptions (some of which are beyond the Company s control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as may, will, believe, expect, estimate, anticipate, continue or similar terms or variations on those terms, or the negative of these terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, the financial and securities markets, and the availability of and costs associated with sources of liquidity.

The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Table of Contents

ITEM 1A. *RISK FACTORS*

The risk factors that may affect the Company s performance and results of operations include the following:

(i) the Company s business is dependent upon general economic conditions in Massachusetts, New Hampshire, Rhode Island, Connecticut, and New York. The national and local economies may adversely affect the Company s performance and results of operations;

(ii) the Company s earnings depend, to a great extent, upon the level of net interest income generated by the Company, and therefore the Company s results of operations may be adversely affected by increases or decreases in interest rates or by the shape of the yield curve;

(iii) the banking business is highly competitive and the profitability of the Company depends upon the Company s ability to attract loans and deposits in Massachusetts, New Hampshire, Rhode Island, Connecticut, and New York, where the Company competes with a variety of traditional banking companies, some of which have vastly greater resources, and nontraditional institutions such as credit unions and finance companies;

(iv) at December 31, 2018, approximately 66.2% of the Company s loan portfolio was comprised of commercial and commercial real estate loans, exposing the Company to the risks inherent in financings based upon analyses of credit risk, the value of underlying collateral, including real estate, and other more intangible factors, which are considered in making commercial loans;

(v) at December 31, 2018, approximately 28.0% of the Company s loan portfolio was comprised of residential real estate and home equity loans, exposing the Company to the risks inherent in financings based upon analyses of credit risk and the value of underlying collateral. Accordingly, the Company s profitability may be negatively impacted by errors in risk analyses, by loan defaults and the ability of certain borrowers to repay such loans may be adversely affected by any downturn in general economic conditions;

(vi) economic conditions and interest rate risk could adversely impact the fair value and the ultimate collectibility of the Company s investments. Should an investment be deemed other than temporarily impaired , the Company would be required to writedown the carrying value of the investment through earnings. Such writedown(s) may have a material adverse effect on the Company s financial condition and results of operations;

(vii) writedown of goodwill and other identifiable intangible assets would negatively impact our financial condition and results of operations. At December 31, 2018, our goodwill and other identifiable intangible assets were approximately $2.7 million;

(viii) acts or threats of terrorism and actions taken by the United States or other governments as a result of such acts or threats, including possible military action, could further adversely affect business and economic conditions in the United States of America generally and in the Company s markets, which could adversely affect the Company s financial performance and that of the Company s borrowers and on the financial markets and the price of the Company s Class A common stock;

(ix) changes in the extensive laws, regulations and policies governing companies generally and bank holding companies and their subsidiaries, such as the Act and the Tax Act, could alter the Company s business environment or affect the Company s operations;

(x) the potential need to adapt to industry changes in information technology systems, on which the Company is highly dependent to secure bank and customer financial information, could present operational issues, require significant capital spending or impact the Company s reputation;

(xi) in the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, and business partners, and personally identifiable information of our customers and employees, in our data centers and on our networks. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or

Table of Contents

other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, and regulatory penalties, disrupt our operations and the services we provide to customers, and damage our reputation, and cause a loss of confidence in our products and services, which could adversely affect our results of operations and competitive position;

(xii) the Company s loan customers may not repay loans according to their terms, and the collateral securing the payment of loans may be insufficient to assure repayment or cover losses. If loan customers fail to repay loans according to the terms of the loans, the Company may experience significant credit losses which could have a material adverse effect on its operating results and capital ratios;

(xiii) the Company is subject to extensive regulation, supervision and examination. Any change in the laws or regulations or failure by the Company to comply with applicable law and regulation, or a change in regulators supervisory policies or examination procedures, whether by the Massachusetts Commissioner of Banks, the FDIC, the Federal Reserve Board, other state or federal regulators, the United States Congress, or the Massachusetts legislature could have a material adverse effect on the Company s business, financial condition, results of operations, and cash flows. Changes in accounting policies, practices and standards, as may be adopted by the regulatory agencies as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standard setters, could also impact the Company s financial results; and

These factors, as well as general economic and market conditions in the United States of America, may materially and adversely affect the Company s performance, results of operations and the market price of shares of the Company s Class A common stock.

ITEM 1B. *UNRESOLVED STAFF COMMENTS*

No written comments received by the Company from the SEC regarding the Company s periodic or current reports remain unresolved.

ITEM 2. *PROPERTIES*

The Company owns its main banking office, headquarters, and operations center in Medford, Massachusetts, which were expanded in 2004, and 11 of the 26 other facilities in which its branch offices are located. The remaining offices are occupied under leases expiring on various dates from 2019 to 2028. The Company believes that its banking offices are in good condition.

During June 2016, the Company entered into a lease agreement to open a new branch located in Wellesley, Massachusetts. The Company closed its existing Wellesley branch and transferred the accounts to the new Wellesley branch which opened on December 19, 2016. On September 25, 2017 the Company purchased the new Wellesley location.

ITEM 3. *LEGAL PROCEEDINGS*

The Company and its subsidiaries are parties to various claims and lawsuits arising in the course of their normal business activities. Although the ultimate outcome of these suits cannot be ascertained at this time, it is the opinion of management that none of these matters, even if it resolved adversely to the Company, will have a material adverse effect on the Company s consolidated financial position.

On September 7, 2017, Crimson Galeria Limited Partnership, Raj & Raj, LLC, Harvard Square Holdings LLC, and Charles River Holdings LLC (collectively, the Plaintiffs) filed suit in the United States District Court for the District of Massachusetts against the Attorney General of the Commonwealth of Massachusetts, the Massachusetts Department of Public Health, the City of Cambridge, the Town of Georgetown, as well as against the Bank, Healthy Pharms, Inc., (Healthy Pharms), Timbuktu Real Estate, LLC, Paul Overgaag, Nathaniel Averill, 4Front Advisors, LLC, 4Front Holdings LLC, Kristopher T. Krane, 3 Brothers Real Estate, LLC, Red Line Management, LLC, unspecified insurance providers to certain Plaintiffs, and Tomolly, Inc., (collectively, the Defendants).

Table of Contents

The Plaintiffs allege that they own property in Cambridge, MA, and claim that the value and use of their property will be impaired by Healthy Pharms decision to open a registered medicinal marijuana dispensary in abutting or nearby situated property. The Plaintiffs further allege that the Bank has a banking relationship with Healthy Pharms and that, by entering into such relationship, the Bank conspired with Healthy Pharms to violate the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 et seq. The Plaintiffs seek unspecified treble damages, and attorney s costs and fees, as well as injunctive and declaratory relief.

On November 13, 2018, the complaint was dismissed with prejudice, effectively barring the plaintiff from ever rebringing the case against the Bank.

ITEM 4. ***MINE SAFETY DISCLOSURES***

Not applicable.

Table of Contents

PART II

ITEM 5. ***MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

(a) The Class A Common Stock of the Company is traded on the NASDAQ National Global Market under the symbol CNBKA. The Company s Class B Common Stock is not traded on any national securities exchange or other public trading market.

The shares of Class A Common Stock are generally not entitled to vote on any matter, including in the election of Company Directors, but, in limited circumstances, may be entitled to vote as a class on certain extraordinary transactions, including any merger or consolidation (other than one in which the Company is the surviving corporation or one which by law may be approved by the directors without any stockholder vote) or the sale, lease, or exchange of all or substantially all of the property and assets of the Company. Since the vote of a majority of the shares of the Company s Class B Common Stock, voting as a separate class, is required to approve certain extraordinary corporate transactions, the holders of Class B Common Stock have the power to prevent any takeover of the Company not approved by them.

(b) Approximate number of equity security holders as of December 31, 2018:

Title of Class	Approximate Number of Record Holders
Class A Common Stock	893
Class B Common Stock	157

(c) The following schedule provides information with respect to the Company s equity compensation plans under which shares of Class A Common Stock are authorized for issuance as of December 31, 2018:

Equity Compensation Plan Information

Plan Category	Number of Shares to be Issued Upon Exercise of Outstanding Options (a)	Weighted-Average Exercise Price of Outstanding Options (b)	Number of Shares Remaining Available for Future Issuance Under Equity Compensation Planes (Excluding Shares Reflected in Column (a)) (c)
Equity compensation plans approved by security holders		$	233,934
Equity compensation plans not approved by security holders			

Total	$	233,934

(d) The performance graph information required herein is shown on page 14.

ITEM 6. ***SELECTED FINANCIAL DATA***

The information required herein is shown on pages 12 through 14.

ITEM 7. ***MANAGEMENT S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION***

The information required herein is shown on pages 15 through 38.

ITEM 7A. ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

The information required herein is shown on pages 35 and 36.

ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

The information required herein is shown on pages 39 through 98.

Table of Contents

ITEM 9. ***CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***

None.

ITEM 9A. ***CONTROLS AND PROCEDURES***

The Company s principal executive officer and principal financial officer have evaluated the Company s disclosure controls and procedures as of December 31, 2018. Based on this evaluation, the principal executive officer and principal financial officer have concluded that the Company s disclosure controls and procedures are effective. The Company s disclosure controls and procedures also effectively ensure that information required to be disclosed in the Company s filings and submissions with the Securities and Exchange Commission under the Securities Exchange Act of 1934 is accumulated and reported to Company management (including the principal executive officer and principal financial officer) and is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. In addition, the Company has reviewed its internal control over financial reporting and there have been no changes that occurred during the fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect its internal control over financial reporting or in other factors that could significantly affect its internal control over financial reporting.

On May 14, 2013, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) released an updated version of its Internal Control Integrated Framework (2013) (2013 Framework). The 2013 Framework s internal control components (i.e., control environment, risk assessment, control activities, information and communication, and monitoring activities) remain predominantly the same as those in the 1992 Framework. However, the 2013 Framework was expanded to include 17 principles which must be present and functioning in order to have an effective system of internal controls. The Company implemented the 2013 Framework effective December 31, 2014.

Management s report on internal control over financial reporting is shown on page 102. The audit report of the registered public accounting firm is shown on page 100.

ITEM 9B. ***OTHER INFORMATION***

None.

Table of Contents

FINANCIAL STATEMENTS

Table of Contents

Financial Highlights

(dollars in thousands, except share data)	2018	2017	2016	2015	2014
FOR THE YEAR					
Interest income	**$ 137,056**	$ 113,436	$ 96,699	$ 90,093	$ 85,371
Interest expense	**44,480**	27,820	22,617	20,134	19,136
Net interest income	**92,576**	85,616	74,082	69,959	66,235
Provision for loan losses	**1,350**	1,790	1,375	200	2,050
Net interest income after provision for loan losses	**91,226**	83,826	72,707	69,759	64,185
Other operating income	**16,248**	16,552	16,222	15,993	15,271
Operating expenses	**69,693**	67,119	64,757	62,198	56,730
Income before income taxes	**37,781**	33,259	24,172	23,554	22,726
Provision for income taxes	**1,568**	10,958	(362)	533	866
Net income	**$ 36,213**	$ 22,301	$ 24,534	$ 23,021	$ 21,860
Core earnings Non-GAAP(1)	**$ 36,213**	$ 30,749	$ 24,534	$ 23,021	$ 21,860
Average shares outstanding Class A, basic	**3,608,179**	3,604,029	3,600,729	3,600,729	3,591,732
Average shares outstanding Class B, basic	**1,959,730**	1,963,880	1,967,180	1,967,180	1,969,030
Average shares outstanding Class A, diluted	**5,567,909**	5,567,909	5,567,909	5,567,909	5,562,209
Average shares outstanding Class B, diluted	**1,959,730**	1,963,880	1,967,180	1,967,180	1,969,030
Total shares outstanding at year-end	**5,567,909**	5,567,909	5,567,909	5,567,909	5,567,909
Earnings per share:					
Basic, Class A	**$ 7.89**	$ 4.86	$ 5.35	$ 5.02	$ 4.78
Basic, Class B	**$ 3.95**	$ 2.43	$ 2.68	$ 2.51	$ 2.39
Diluted, Class A	**$ 6.50**	$ 4.01	$ 4.41	$ 4.13	$ 3.93
Diluted, Class B	**$ 3.95**	$ 2.43	$ 2.68	$ 2.51	$ 2.39
Dividend payout ratio Non-GAAP(1)	**6.1%**	9.9%	9.0%	9.6%	10.0%
AT YEAR-END					
Assets	**$ 5,163,935**	$ 4,785,572	$ 4,462,608	$ 3,947,441	$ 3,624,036
Loans	**2,285,578**	2,175,944	1,923,933	1,731,536	1,331,366
Deposits	**4,406,964**	3,916,967	3,653,218	3,075,060	2,737,591
Stockholders equity	**300,439**	260,297	240,041	214,544	192,500

Book value per share	**$ 53.96**	$ 46.75	$ 43.11	$ 38.53	$ 34.57
SELECTED FINANCIAL PERCENTAGES					
Return on average assets	**0.74%**	0.48%	0.57%	0.59%	0.61%
Return on average stockholders equity	**13.05%**	8.75%	10.80%	11.26%	11.57%
Net interest margin, taxable equivalent	**2.18%**	2.25%	2.12%	2.18%	2.22%
Net (recoveries) charge-offs as a percent of average loans	**(0.04)%**	0.00%	0.00%	(0.04)%	0.05%
Average stockholders equity to average assets	**5.71%**	5.50%	5.29%	5.25%	5.27%
Efficiency ratio Non-GAAP(1)	**59.2%**	57.8%	62.7%	64.1%	62.0%

Table of Contents

Financial Highlights (Continued)

(1) Non-GAAP Financial Measures are reconciled in the following tables:

	2018	2017	2016	2015	2014
Calculation of Efficiency Ratio:					
Total Operating Expenses (numerator)	**$ 69,693**	$ 67,119	$ 64,757	$ 62,198	$ 56,730
Net Interest Income	**92,576**	85,616	74,082	69,959	66,235
Total Other Operating Income	**16,248**	16,552	16,222	15,993	15,271
Tax Equivalent Adjustment	**8,854**	13,979	12,917	11,140	10,033
Total Income (denominator)	**$ 117,678**	$ 116,147	$ 103,221	$ 97,092	$ 91,539
Efficiency Ratio, Year Non-GAAP	**59.2%**	57.8%	62.7%	64.1%	62.0%

	2018	2017	2016	2015	2014
Calculation of Dividend Payout Ratio:					
Dividends Paid (numerator)	**$ 2,203**	$ 2,200	$ 2,201	$ 2,200	$ 2,196
Net Income (denominator)	**$ 36,213**	$ 22,301	$ 24,534	$ 23,021	$ 21,860
Dividend Payout Ratio Non-GAAP	**6.1%**	9.9%	9.0%	9.6%	10.0%

	2018	2017	2016	2015	2014
Calculation of core earnings:					
Net Income	**$ 36,213**	$ 22,301	$ 24,534	$ 23,021	$ 21,860
Add: Deferred Tax Remeasurement Charge		8,448			
Core earnings Non-GAAP	**$ 36,213**	$ 30,749	$ 24,534	$ 23,021	$ 21,860

Table of Contents

Financial Highlights (Continued)

The stock performance graph below compares the cumulative total shareholder return of the Company s Class A Common Stock from December 31, 2013 to December 31, 2018 with the cumulative total return of the NASDAQ Market Index (U.S. Companies) and the NASDAQ Bank Stock Index. The lines in the graph represent monthly index levels derived from compounded daily returns that include all dividends. If the monthly interval, based on the fiscal year-end, was not a trading day, the preceding trading day was used.

Comparison of Five-Year

Cumulative Total Return*

Value of $100 Invested on December 31, 2013 at:	**2014**	**2015**	**2016**	**2017**	**2018**
Century Bancorp, Inc.	$ 122.10	$ 134.02	$ 186.98	$ 245.54	**$ 213.92**
NASDAQ Banks	111.83	114.30	144.63	171.24	**143.15**
NASDAQ U.S.	114.75	122.74	133.62	173.22	**168.30**

* Assumes that the value of the investment in the Company s Common Stock and each index was $100 on December 31, 2013 and that all dividends were reinvested.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition

FORWARD-LOOKING STATEMENTS

Certain statements contained herein are not based on historical facts and are forward-looking statements within the meaning of Section 21A of the Securities Exchange Act of 1934. Forward-looking statements, which are based on various assumptions (some of which are beyond the Company s control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as may, will, believe, expect, estimate, anticipate, continue or similar terms or variations on those terms, or the negative of these terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, the financial and securities markets, and the availability of and costs associated with sources of liquidity.

The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

RECENT MARKET DEVELOPMENTS

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the D-F Act) became law. The D-F Act was intended to address many issues arising in the recent financial crisis and is exceedingly broad in scope, affecting many aspects of bank and financial market regulation. The D-F Act requires, or permits by implementing regulation, enhanced prudential standards for banks and bank holding companies inclusive of capital, leverage, liquidity, concentration and exposure measures. In addition, traditional bank regulatory principles such as restrictions on transactions with affiliates and insiders were enhanced. The D-F Act also contains reforms of consumer mortgage lending practices and creates a Bureau of Consumer Financial Protection, which is granted broad authority over consumer financial practices of banks and others. It is expected as the specific new or incremental requirements applicable to the Company become effective that the costs and difficulties of remaining compliant with all such requirements will increase. The D-F Act broadened the base for FDIC assessments to average consolidated assets less tangible equity of financial institutions and also permanently raises the current standard maximum FDIC deposit insurance amount to $250,000. The Act extended unlimited deposit insurance on non-interest bearing transaction accounts through December 31, 2012.

In addition, the D-F Act added a new Section 13 to the Bank Holding Company Act, the so-called Volcker Rule, (the Rule) which generally restricts certain banking entities such as the Company and its subsidiaries or affiliates, from engaging in proprietary trading activities and owning equity in or sponsoring any private equity or hedge fund. The Rule became effective July 21, 2012. The final implementing regulations for the Rule were issued by various regulatory agencies in December, 2013 and under an extended conformance regulation compliance was required to be achieved by July 21, 2015. The conformance period for investments in and relationships with certain legacy covered funds was extended to July 21, 2017. Under the Rule, the Company may be restricted from engaging in proprietary trading, investing in third party hedge or private equity funds or sponsoring new funds unless it qualifies for an exemption from the rule. The Company has little involvement in prohibited proprietary trading or investment activities in covered funds and the Company does not expect that complying with the requirements of the Rule will have any material effect on the Company s financial condition or results of operation. The federal banking agencies have issued notices of proposed rulemaking to make certain amendments to the Rule to simplify and tailor compliance requirements and to conform the Rule to the EGRRCPA (discussed below).

Federal banking regulators have issued risk-based capital guidelines, which assign risk factors to asset categories and off-balance-sheet items. Also, the Basel Committee has issued capital standards entitled Basel III: A global regulatory framework for more resilient banks and banking systems (Basel III). The Federal Reserve Board has finalized its rule implementing the Basel III regulatory capital framework. The rule that came

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

into effect in January 2015 sets the Basel III minimum regulatory capital requirements for all organizations. It included a new common equity Tier I ratio of 4.5 percent of risk-weighted assets, raised the minimum Tier I capital ratio from 4 percent to 6 percent of risk-weighted assets and would set a new conservation buffer of 2.5 percent of risk-weighted assets. The implementation of the framework did not have a material impact on the Company s financial condition or results of operations.

On December 22, 2017, the Tax Cuts and Jobs Act (the Tax Act) was enacted, which represents the most comprehensive reform to the U.S. tax code in over thirty years. The majority of the provisions of the Tax Act took effect on January 1, 2018. The Tax Act lowered the Company s federal tax rate from 34% to 21%. Also, for tax years beginning after December 31, 2017, the corporate Alternative Minimum Tax (AMT) has been repealed. For 2018 through 2021, the AMT credit carryforward can offset regular tax liability and is refundable in an amount equal to 50% (100% for 2021) of the excess of the minimum tax credit for the tax year over the amount of the credit allowable for the year against regular tax liability. Accordingly, it is anticipated that the full amount of the alternative minimum tax credit carryforward will be recovered in tax years beginning before 2022. The Tax Act also contains other provisions that may affect the Company currently or in future years. Among these are changes to the deductibility of meals and entertainment, the deductibility of executive compensation, the dividend received deduction and net operating loss carryforwards. Tax Act changes for individuals include lower tax rates, mortgage interest and state and local tax limitations as well as an increase in the standard deduction, among others.

On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act, or the EGRRCPA, became law. This is arguably the most significant financial institution legislation since the D-F Act. The EGRRCPA changes certain of the regulatory requirements of the D-F Act and includes provisions intended to relieve the regulatory burden on community banks. Among other things, for qualifying community banks with less than $10 billion in total consolidated assets, the EGRRCPA contains a safe harbor from the D-F Act ability to repay mortgage requirements, an exemption from the Volcker Rule, may permit filing of simplified Call Reports, and potentially will result in some alleviation of the D-F Act and U.S. Basel III capital mandates. The EGRRCPA requires the federal banking agencies to develop a community bank leverage ratio (defined as the ratio of tangible equity capital to average total consolidated assets) for banks and holding companies with total consolidated assets of less than $10 billion and an appropriate risk profile. The required regulations must specify a minimum community bank leverage ratio of not less than 8% and not more than 10%. The federal banking agencies jointly issued a notice of proposed rulemaking which would set the minimum ratio at 9%. Qualifying banks that exceed the minimum community bank leverage ratio will be deemed to be in compliance with all other capital and leverage requirements including the capital ratio requirements that are required to be considered well capitalized under Section 38 of Federal Deposit Insurance Act.

OVERVIEW

Century Bancorp, Inc. (together with its bank subsidiary, unless the context otherwise requires, the Company) is a Massachusetts state-chartered bank holding company headquartered in Medford, Massachusetts. The Company is a Massachusetts corporation formed in 1972 and has one banking subsidiary (the Bank): Century Bank and Trust Company formed in 1969. At December 31, 2018, the Company had total assets of $5.2 billion. Currently, the Company operates 27 banking offices in 20 cities and towns in Massachusetts, ranging from Braintree in the south to Andover in the north. The Bank s customers consist primarily of small and medium-sized businesses and retail customers in these communities and surrounding areas, as well as local governments and large healthcare and higher education institutions throughout Massachusetts, New Hampshire, Rhode Island, Connecticut and New York.

The Company s results of operations are largely dependent on net interest income, which is the difference between the interest earned on loans and securities and interest paid on deposits and borrowings. The results of operations are also affected by the level of income and fees from loans, deposits, as well as operating expenses, the provision for loan losses, the impact of federal and state income taxes and the relative levels of interest rates and economic activity.

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

The Company offers a wide range of services to commercial enterprises, state and local governments and agencies, non-profit organizations and individuals. It emphasizes service to small and medium sized businesses and retail customers in its market area. In recent years, the Company has increased business to larger institutions, specifically, healthcare and higher education. The Company makes commercial loans, real estate and construction loans and consumer loans, and accepts savings, time, and demand deposits. In addition, the Company offers its corporate and institutional customers automated lock box collection services, cash management services and account reconciliation services, and actively promotes the marketing of these services to the municipal market. Also, the Company provides full service securities brokerage services through a program called Investment Services at Century Bank, which is supported by LPL Financial, a third party full-service securities brokerage business.

The Company has municipal cash management client engagements in Massachusetts, New Hampshire and Rhode Island comprised of approximately 250 government entities.

The Company had net income of $36,213,000 for the year ended December 31, 2018, compared with net income of $22,301,000 for the year ended December 31, 2017, and net income of $24,534,000 for the year ended December 31, 2016. Class A diluted earnings per share were $6.50 in 2018 compared to $4.01 in 2017 and compared to $4.41 in 2016.

During 2017, the Company s earnings were negatively impacted by a reduction in the value of its net deferred tax asset resulting in a charge of $8.4 million to income tax expense. This was the result of the enactment of the Tax Act on December 22, 2017, which lowered the Company s federal tax rate from 34% to 21%. During 2018 and 2017, the Company s earnings were positively impacted primarily by an increase in net interest income. This increase was primarily due to an increase in earning assets. During 2016, the U.S. economy experienced a low short-term rate environment. The lower short-term rates negatively impacted the net interest margin as the rate at which short-term deposits could be invested declined more than the rates offered on those deposits.

Earnings per share (EPS) for each class of stock and for each year ended December 31, is as follows:

	2018	2017	2016
Basic EPS Class A common	**$ 7.89**	$ 4.86	$ 5.35
Basic EPS Class B common	**$ 3.95**	$ 2.43	$ 2.68
Diluted EPS Class A common	**$ 6.50**	$ 4.01	$ 4.41
Diluted EPS Class B common	**$ 3.95**	$ 2.43	$ 2.68

The trends in the net interest margin are illustrated in the graph below:

Net Interest Margin

The net interest margin decreased during the second, third, and fourth quarters of 2016 primarily as a result of a decrease in rates on earning assets. The margin increased during 2017 primarily as a result of an increase in rates on earning assets. This increase was primarily the result of the yield on floating rate assets increasing as a result of recent increases in short term interest rates as well as an increase in prepayment penalties collected during the second quarter of 2017. Prepayment penalties collected amounted to $825,000 and contributed approximately seven basis points to the net interest margin for the second quarter of 2017. During 2017, the Company did not see a corresponding increase in short term rates on interest bearing liabilities. The margin

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

decreased for 2018 mainly as a result of a decrease in the corporate tax rate from 34% to 21%. This decrease results in a lower tax equivalent yield on tax-exempt assets. During the fourth quarter of 2018, the Company increased its interest-bearing deposits. These deposits increased net interest income, but decreased the net interest margin. While management will continue its efforts to improve the net interest margin, there can be no assurance that certain factors beyond its control, such as the prepayment of loans and changes in market interest rates, will continue to positively impact the net interest margin.

Historical U.S. Treasury Yield Curve

A yield curve typically plots the interest rates of U.S. Treasury Debt, which have different maturity dates but the same credit quality, at a specific point in time. The three main types of yield curve shapes are normal, inverted and flat. Over the past three years, the U.S. economy has experienced low short-term rates. During 2017 and 2018, short-term rates increased more than longer-term rates resulting in a flattening of the yield curve. This flattening of the yield curve became more pronounced during 2017 and 2018.

Total assets were $5,163,935,000 at December 31, 2018, an increase of 7.9% from total assets of $4,785,572,000 at December 31, 2017.

On December 31, 2018, stockholders equity totaled $300,439,000, compared with $260,297,000 on December 31, 2017. Book value per share increased to $53.96 at December 31, 2018, from $46.75 on December 31, 2017.

During June 2016, the Company entered into a lease agreement to open a new branch located in Wellesley, Massachusetts. The Company closed its existing Wellesley branch and transferred the accounts to the new Wellesley branch which opened on December 19, 2016. On September 25, 2017 the Company purchased the new Wellesley location.

CRITICAL ACCOUNTING POLICIES

Accounting policies involving significant judgments and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets and impact income, are considered critical accounting policies.

The Company considers allowance for loan losses and income taxes to be its critical accounting policies.

Allowance for Loan Losses

Arriving at an appropriate level of allowance for loan losses necessarily involves a high degree of judgment. Management maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance is based on assessments of the probable estimated losses inherent in the loan portfolio. Management s methodology for assessing the appropriateness of the allowance consists of several key elements, which include

18

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

the specific allowances, if appropriate, for identified problem loans, formula allowance, and possibly an unallocated allowance. Arriving at an appropriate level of allowance for loan losses necessarily involves a high degree of judgment.

Specific allowances for loan losses entail the assignment of allowance amounts to individual loans on the basis of loan impairment. Under this method, loans are selected for evaluation based upon a change in internal risk rating, occurrence of delinquency, loan classification or nonaccrual status. The formula allowances are based on evaluations of homogenous loans to determine the allocation appropriate within each portfolio segment. Formula allowances are based on internal risk ratings or credit ratings from external sources. After considering the above components, an unallocated component may be generated to cover uncertainties that could affect management s estimate of probable losses. Further information regarding the Company s methodology for assessing the appropriateness of the allowance is contained within Note 1 of the Notes to Consolidated Financial Statements .

During 2017 and 2018, the Company further enhanced its methodology to the allowance for loan losses by including additional metrics for qualitative factors on certain loan portfolios. Further enhancements and refinements include adding qualitative factors to certain loan portfolios to enhance granularity. The Company also updated and added data sources to measure present and forecasted economic conditions. Management believes that the allowance for loan losses is adequate. In addition, various regulatory agencies, as part of the examination process, periodically review the Company s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

FINANCIAL CONDITION

Investment Securities

The Company s securities portfolio consists of securities available-for-sale (AFS), securities held-to-maturity (HTM), and equity securities.

Securities available-for-sale consist of certain U.S. Treasury, U.S. Government Sponsored Enterprises, SBA Backed Securities, and U.S. Government Sponsored Enterprise mortgage-backed securities; state, county and municipal securities; privately issued mortgage-backed securities; and other debt securities.

These securities are carried at fair value, and unrealized gains and losses, net of applicable income taxes, are recognized as a separate component of stockholders equity. The fair value of securities available-for-sale at December 31, 2018 totaled $336,759,000 and included gross unrealized gains of $635,000 and gross unrealized losses of $627,000. A year earlier, the fair value of securities available-for-sale was $395,830,000 including gross unrealized gains of $673,000 and gross unrealized losses of $790,000. In 2018, the Company recognized gains of $302,000 on the sale of available-for-sale securities. In 2017 and 2016, the Company recognized gains of $47,000 and $52,000, respectively.

Securities classified as held-to-maturity consist of U.S. Government Sponsored Enterprises, SBA Backed Securities, and U.S. Government Sponsored Enterprise mortgage-backed securities. Securities held-to-maturity as of December 31, 2018 are carried at their amortized cost of $2,046,647,000. A year earlier, securities held-to-maturity totaled $1,701,233,000. In 2018, 2017, and 2016, the company recognized gains of $0 and $0, and $12,000 respectively, on the sale of held-to-maturity securities. The sales from securities held-to-maturity relate to certain mortgage-backed securities for which the Company had previously collected a substantial portion of its principal investment.

Equity securities are reported at fair value with unrealized gains and losses included in earnings. The fair value of equity securities at December 31, 2018 and December 31, 2017, amounted to $1,596,000 and $1,663,000, respectively.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

The following table sets forth the fair value and percentage distribution of securities available-for-sale at the dates indicated.

Fair Value of Securities Available-for-Sale

At December 31, (dollars in thousands)	2018 Amount	2018 Percent	2017 Amount	2017 Percent	2016 Amount	2016 Percent
U.S. Treasury	**$ 1,992**	**0.6%**	$ 1,984	0.5%	$ 2,000	0.4%
U.S. Government Sponsored Enterprises	**3,915**	**1.2%**		0.0%	24,952	5.0%
SBA Backed Securities	**70,194**	**20.9%**	80,950	20.5%	57,767	11.6%
U.S. Government Agency and Sponsored Enterprises Mortgage-Backed Securities	**162,890**	**48.4%**	225,775	57.0%	243,325	48.9%
Privately Issued Residential Mortgage-Backed Securities	**672**	**0.2%**	892	0.2%	1,109	0.2%
Obligations Issued by States and Political Subdivisions	**93,503**	**27.7%**	82,600	20.9%	164,876	33.2%
Other Debt Securities	**3,593**	**1.0%**	3,629	0.9%	3,569	0.7%
Total	**$ 336,759**	**100.0%**	$ 395,830	100.0%	$ 497,598	100.0%

The majority of the Company s securities AFS are classified as Level 2, as defined in Note 1 of the Notes to Consolidated Financial Statements. The fair values of these securities are obtained from a pricing service, which provides the Company with a description of the inputs generally utilized for each type of security. These inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. Management s understanding of a pricing service s pricing methodologies includes obtaining an understanding of the valuation risks, assessing its qualification, verification of sources of information and processes used to develop prices and identifying, documenting, and testing controls. Management s validation of a vendor s pricing methodology includes establishing internal controls to determine that the pricing information received by a pricing service and used by management in the valuation process is relevant and reliable. Market indicators and industry and economic events are also monitored. The decline in fair value from amortized cost for individual available-for-sale securities that are temporarily impaired is not attributable to changes in credit quality. Because the Company does not intend to sell any of its debt securities and it is not more likely than not that it will be required to sell the debt securities before the anticipated recovery of their remaining amortized cost, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2018.

The increase in SBA Backed Securities in 2017 was primarily the result of an increased investment return combined with a lower risk rating in these types of securities. The decrease in Obligations Issued by States and Political Subdivisions was primarily the result of increased competition in the bidding process for these types of securities.

Securities available-for-sale totaling $88,728,000, or 1.7% of assets, are classified as Level 3, as defined in Note 1 of the Notes to Consolidated Financial Statements. These securities are generally municipal securities with no readily determinable fair value. The Company also utilizes internal pricing analysis on various municipal securities using market rates on comparable securities. The securities are carried at fair value with periodic review of underlying financial statements and credit ratings to assess the appropriateness of these valuations.

Debt securities of Government Sponsored Enterprises refer primarily to debt securities of Fannie Mae and Freddie Mac.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

The following table sets forth the amortized cost and percentage distribution of securities held-to-maturity at the dates indicated.

Amortized Cost of Securities Held-to-Maturity

	2018		2017		2016	
At December 31, (dollars in thousands)	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
U.S. Treasury	**$ 9,960**	**0.5%**	$	0.0%	$	0.0%
U.S. Government Sponsored Enterprises	**234,228**	**11.5%**	104,653	6.2%	148,326	9.0%
SBA Backed Securities	**52,051**	**2.5%**	57,235	3.4%	46,140	2.8%
U.S. Government Sponsored Enterprise Mortgage-Backed Securities	**1,750,408**	**85.5%**	1,539,345	90.4%	1,459,520	88.2%
Total	**$ 2,046,647**	**100.0%**	$ 1,701,233	100.0%	$ 1,653,986	100.0%

21

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

The following two tables set forth contractual maturities of the Bank s securities portfolio at December 31, 2018. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Fair Value of Securities Available-for-Sale Amounts Maturing

	Within One Year	% of Total	Weighted Average Yield	One Year to Five Years	% of Total	Weighted Average Yield	Five Years to Ten Years	% of Total	Weighted Average Yield	Over Ten Years	% of Total	Weighted Average Yield	Total	% T
	$ 1,992	0.6%	1.28%	$	0.0%	0.00%	$	0.0%	0.00%	$	0.0%	0.00%	$ 1,992	
t		0.0%	0.00%	3,915	1.2%	2.27%		0.0%	0.00%		0.0%	0.00%	3,915	
	132	0.1%	2.12%	42,310	12.6%	2.73%	13,574	4.0%	2.92%	14,178	4.2%	2.89%	70,194	
t d	1,227	0.4%	2.81%	35,648	10.6%	2.97%	121,507	36.0%	2.99%	4,508	1.4%	3.13%	162,890	
d	672	0.2%	2.30%		0.0%	0.00%		0.0%	0.00%		0.0%	0.00%	672	
	88,095	26.1%	2.62%	483	0.1%	3.75%	150	0.1%	4.04%	4,775	1.4%	3.68%	93,503	
	800	0.2%	2.79%	756	0.2%	2.32%	1,013	0.3%	6.00%	1,024	0.3%	6.00%	3,593	
	$ 92,918	27.6%	2.59%	$ 83,112	24.7%	2.81%	$ 136,244	40.4%	3.00%	$ 24,485	7.3%	3.22%	$ 336,759	1

Amortized Cost of Securities Held-to-Maturity Amounts Maturing

Within One Year	% of Total	Weighted Average Yield	One Year to Five Years	% of Total	Weighted Average Yield	Five Years to Ten Years	% of Total	Weighted Average Yield	Over Ten Years	% of Total	Weighted Average Yield	Total
$ 9,960	0.5%	2.28%	$	0.0%	0.00%	$	0.0%	0.00%	$	0.0%	0.00%	$ 9,960
24,915	1.2%	2.11%	209,313	10.2%	2.71%		0.0%	0.00%		0.0%	0.00%	234,228
	0.0%	0.00%	52,051	2.5%	2.28%		0.0%	0.00%		0.0%	0.00%	52,051
6,279	0.3%	2.21%	1,229,590	60.1%	2.63%	506,654	24.8%	2.54%	7,885	0.4%	2.92%	1,750,408
$ 41,154	2.0%	2.17%	$ 1,490,954	72.8%	2.63%	$ 506,654	24.8%	2.54%	$ 7,885	0.4%	2.92%	$ 2,046,647

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

At December 31, 2018 and 2017, the Bank had no investments in obligations of individual states, counties, municipalities or nongovernment corporate entities which exceeded 10% of stockholders equity. In 2018, sales of securities totaling $27,517,000 in gross proceeds resulted in a net realized gain of $302,000. In 2017, sales of securities totaling $18,180,000 in gross proceeds resulted in a net realized gain of $47,000. There were no sales of state, county or municipal securities during 2018 and 2017.

Management reviews the investment portfolio for other-than-temporary impairment of individual securities on a regular basis. The results of such analysis are dependent upon general market conditions and specific conditions related to the issuers of our securities.

Loans

The Company s lending activities are conducted principally in Massachusetts, New Hampshire, Rhode Island, Connecticut and New York. The Company grants single-family and multi-family residential loans, commercial and commercial real estate loans, municipal loans, and a variety of consumer loans. To a lesser extent, the Company grants loans for the construction of residential homes, multi-family properties, commercial real estate properties and land development. Most loans granted by the Company are secured by real estate collateral. The ability and willingness of commercial real estate, commercial, construction, residential and consumer loan borrowers to honor their repayment commitments are generally dependent on the health of the real estate market in the borrowers geographic areas and of the general economy.

The following summary shows the composition of the loan portfolio at the dates indicated.

	2018		2017		2016		2015		2014	
December 31, (dollars in thousands)	**Amount**	**Percent of Total**	**Amount**	**Percent of Total**	**Amount**	**Percent of Total**	**Amount**	**Percent of Total**	**Amount**	**Percent of Total**
Construction and land development	**$ 13,628**	**0.6%**	$ 18,931	0.9%	$ 14,928	0.8%	$ 27,421	1.6%	$ 22,744	1.7%
Commercial and industrial	**761,625**	**33.3%**	763,807	35.1%	612,503	31.8%	452,235	26.1%	149,732	11.2%
Municipal	**97,290**	**4.3%**	106,599	4.9%	135,418	7.0%	85,685	4.9%	41,850	3.1%
Commercial real estate	**750,362**	**32.8%**	732,491	33.7%	696,173	36.2%	721,506	41.7%	696,272	52.3%
Residential real estate	**348,250**	**15.2%**	287,731	13.2%	241,357	12.5%	255,346	14.7%	257,305	19.3%
Consumer	**21,359**	**0.9%**	18,458	0.8%	11,013	0.6%	10,744	0.6%	10,925	0.8%
Home equity	**292,340**	**12.9%**	247,345	11.4%	211,857	11.0%	178,020	10.3%	151,275	11.4%

Overdrafts	**724**	**0.0%**	582	0.0%	684	0.1%	579	0.1%	1,263	0.2%
Total	**$ 2,285,578**	**100.0%**	$ 2,175,944	100.0%	$ 1,923,933	100.0%	$ 1,731,536	100.0%	$ 1,331,366	100.0%

At December 31, 2018, 2017, 2016, 2015 and 2014, loans were carried net of (premiums) discounts of $(364,000), $46,000, $313,000, $360,000 and $407,000, respectively. Net deferred loan fees of $496,000, $588,000, $641,000, $988,000 and $908,000 were carried in 2018, 2017, 2016, 2015 and 2014, respectively.

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

The following table summarizes the remaining maturity distribution of certain components of the Company s loan portfolio on December 31, 2018. The table excludes loans secured by 1 4 family residential real estate, loans for household and family personal expenditures, and municipal loans. Maturities are presented as if scheduled principal amortization payments are due on the last contractual payment date.

Remaining Maturities of Selected Loans at December 31, 2018

(dollars in thousands)	One Year or Less	One to Five Years	Over Five Years	Total
Construction and land development	$	$	$ 13,628	$ 13,628
Commercial and industrial	36,546	44,682	680,397	761,625
Commercial real estate	21,342	102,411	626,609	750,362
Total	$ 57,888	$ 147,093	$ 1,320,634	$ 1,525,615

The following table indicates the rate variability of the above loans due after one year.

December 31, 2018 (dollars in thousands)	One to Five Years	Over Five Years	Total
Predetermined interest rates	$ 94,201	$ 334,753	$ 428,954
Floating or adjustable interest rates	52,892	985,881	1,038,773
Total	$ 147,093	$ 1,320,634	$ 1,467,727

The Company s commercial and industrial (C&I) loan customers include large healthcare and higher education institutions. During 2017, the Company increased its lending activities to these types of organizations. This increase may expose the Company to concentration risks inherent in financings based upon analysis of credit risk, the value of underlying collateral, and other more intangible factors, which are considered in originating commercial loans. The percentage of these types of organizations to total C&I loans has decreased to 86% at December 31, 2018, compared to 87% at December 31, 2017.

C&I loan customers also include various small and middle-market established businesses involved in manufacturing, distribution, retailing and services. Most clients are privately owned with markets that range from local to national in scope. Many of the loans to this segment are secured by liens on corporate assets and the personal guarantees of the principals. The regional economic strength or weakness impacts the relative risks in this loan category. There is little concentration in any one business sector, and loan risks are generally diversified among many borrowers.

Commercial real estate loans are extended to educational institutions, hospitals and other non-profit organizations. Loans are normally extended in amounts up to a maximum of 80% of appraised value and normally for terms between three and thirty years. Also included in commercial real estate loans are loans extended to finance various manufacturing, warehouse, light industrial, office, retail and residential properties in the Bank s market area, which generally includes Massachusetts, New Hampshire, and Rhode Island.

Amortization schedules are long term and thus a balloon payment is generally due at maturity. Under most circumstances, the Bank will offer to rewrite or otherwise extend the loan at prevailing interest rates. During recent years, the Bank has emphasized nonresidential-type owner-occupied properties. This complements our C&I emphasis placed on the operating business entities and will continue. The regional economic environment affects the risk of both nonresidential and residential mortgages.

Municipal loans customers include loans to municipalities or related interests, primarily for infrastructure projects. The Company had increased its lending activities to municipalities through 2016. Municipal loans decreased during 2017 and 2018 as a result of loan payoffs.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

Residential real estate (1 4 family) includes two categories of loans. Included in residential real estate are approximately $41,726,000 of C&I type loans secured by 1 4 family real estate. Primarily, these are small businesses with modest capital or shorter operating histories where the collateral mitigates some risk. This category of loans shares similar risk characteristics with the C&I loans, notwithstanding the collateral position.

The other category of residential real estate loans is mostly 1 4 family residential properties located in the Bank s market area. General underwriting criteria are largely the same as those used by Fannie Mae. The Bank utilizes mortgage insurance to provide lower down payment products and has provided a First Time Homebuyer product to encourage new home ownership. Residential real estate loan volume has increased and remains a core consumer product. The economic environment impacts the risks associated with this category.

Home equity loans are extended as both first and second mortgages on owner-occupied residential properties in the Bank s market area. Loans are underwritten to a maximum loan to property value of 75%.

Bank officers evaluate the feasibility of construction projects based on independent appraisals of the project, architects or engineers evaluations of the cost of construction and other relevant data. As of December 31, 2018, the Company was obligated to advance a total of $28,746,000 to complete projects under construction.

The composition of nonperforming assets is as follows:

December 31, (dollars in thousands)	**2018**	2017	2016	2015	2014
Total nonperforming loans	**$ 1,313**	$ 1,684	$ 1,084	$ 2,336	$ 4,146
Other real estate owned	**2,225**				
Total nonperforming assets	**$ 3,538**	$ 1,684	$ 1,084	$ 2,336	$ 4,146
Accruing troubled debt restructured loans	**$ 2,559**	$ 2,749	$ 3,526	$ 2,893	$ 3,296
Loans past due 90 and still accruing					
Nonperforming loans as a percent of gross loans	**0.15%**	0.08%	0.06%	0.13%	0.31%
Nonperforming assets as a percent of total assets	**0.07%**	0.04%	0.02%	0.06%	0.11%

The composition of impaired loans is as follows:

	2018	**2017**	**2016**	**2015**	**2014**
Residential real estate, multi-family	**$**	$ 4,212	$ 198	$ 916	$ 962
Home equity				90	92
Commercial real estate	**2,650**	2,554	3,149	1,678	4,318

Construction and land development			94	98	103
Commercial and industrial	**401**	348	389	443	852
Total impaired loans	**$ 3,051**	$ 7,114	$ 3,830	$ 3,225	$ 6,327

At December 31, 2018, 2017, 2016, 2015 and 2014 impaired loans had specific reserves of $145,000, $164,000, $173,000, $250,000 and $904,000, respectively.

The Company was servicing mortgage loans sold to others without recourse of approximately $209,160,000, $229,533,000, $229,730,000, $185,299,000 and $143,696,000 at December 31, 2018, 2017, 2016, 2015 and 2014, respectively. The Company had no loans held for sale at December 31, 2018, 2017, 2016, 2015 and 2014.

Servicing assets are recorded at fair value and recognized as separate assets when rights are acquired through sale of loans with servicing rights retained. Mortgage servicing assets (MSA) are amortized into non-interest income in proportion to, and over the period of, the estimated net servicing income. Upon sale, the mortgage servicing asset is established, which represents the then-current estimated fair value based on market

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Servicing rights are assessed for impairment based on fair value at each reporting date. MSAs are reported in other assets in the consolidated balance sheets. MSAs totaled $1,226,000 at December 31, 2018, $1,525,000 at December 31, 2017, $1,629,000 at December 31, 2016, $1,305,000 at December 31, 2015 and $941,000 at December 31, 2014.

Directors and officers of the Company and their associates are customers of, and have other transactions with, the Company in the normal course of business. All loans and commitments included in such transactions were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and do not involve more than normal risk of collection or present other unfavorable features.

Loans are placed on nonaccrual status when any payment of principal and/or interest is 90 days or more past due, unless the collateral is sufficient to cover both principal and interest and the loan is in the process of collection. The Company monitors closely the performance of its loan portfolio. In addition to internal loan review, the Company has contracted with an independent organization to review the Company s commercial and commercial real estate loan portfolios. This independent review was performed in each of the past five years. The status of delinquent loans, as well as situations identified as potential problems, is reviewed on a regular basis by senior management and monthly by the Board of Directors of the Bank.

Nonaccrual loans remained relatively stable from 2016 through 2018. Nonaccrual loans decreased during 2016, primarily as a result of a decrease in home equity and residential real estate nonperforming loans. Nonaccrual loans decreased during 2015 primarily due to the sale and partial charge-off of the property securing a large commercial real estate loan subsequent to foreclosure.

The Company continues to monitor closely $31,728,000 and $37,184,000 at December 31, 2018 and 2017, respectively, of loans for which management has concerns regarding the ability of the borrowers to perform. The majority of the loans are secured by real estate and are considered to have adequate collateral value to cover the loan balances at December 31, 2018, although such values may fluctuate with changes in the economy and the real estate market. The decrease is primarily attributable to two loan relationships secured by real estate.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

Allowance for Loan Losses

The Company maintains an allowance for loan losses in an amount determined by management on the basis of the character of the loans, loan performance, financial condition of borrowers, the value of collateral securing loans and other relevant factors. The following table summarizes the changes in the Company s allowance for loan losses for the years indicated.

Year Ended December 31, (dollars in thousands)	**2018**	**2017**	**2016**	**2015**	**2014**
Year-end loans outstanding (net of unearned discount and deferred loan fees)	**$ 2,285,578**	$ 2,175,944	$ 1,923,933	$ 1,731,536	$ 1,331,366
Average loans outstanding (net of unearned discount and deferred loan fees)	**$ 2,222,946**	$ 2,059,797	$ 1,838,136	$ 1,507,546	$ 1,307,888
Balance of allowance for loan losses at the beginning of year	**$ 26,255**	$ 24,406	$ 23,075	$ 22,318	$ 20,941
Loans charged-off:					
Commercial and industrial	**67**	49			333
Construction				172	500
Commercial real estate				298	
Residential real estate	**450**		27		24
Consumer	**316**	341	362	311	525
Total loans charged-off	**833**	390	389	781	1,382
Recovery of loans previously charged-off:					
Commercial and industrial	**57**	110	132	212	201
Construction	**1,436**			780	
Real estate	**75**	84	6	91	117
Consumer	**203**	255	296	255	391
Total recoveries of loans previously charged-off:	**1,771**	449	434	1,338	709

Net loan (recoveries) charge-offs	**(938)**	(59)	(45)	(557)	673
Provision charged to operating expense	**1,350**	1,790	1,375	200	2,050
Reclassification to other liabilities			(89)		
Balance at end of year	**$ 28,543**	$ 26,255	$ 24,406	$ 23,075	$ 22,318
Ratio of net (recoveries) charge-offs during the year to average loans outstanding	**(0.04)%**	0.00%	0.00%	(0.04)%	0.05%
Ratio of allowance for loan losses to loans outstanding	**1.25%**	1.21%	1.27%	1.33%	1.68%

The amount of the allowance for loan losses results from management s evaluation of the quality of the loan portfolio considering such factors as loan status, specific reserves on impaired loans, collateral values, financial condition of the borrower, the state of the economy and other relevant information. The level of the charge-offs

27

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

depends on many factors, including the national and regional economy. Cyclical lagging factors may result in charge-offs being higher than historical levels. Charge-offs declined in 2015 and 2016 as a result of the overall decrease in the level of nonaccrual loans. Charge-offs increased in 2018 primarily as a result of one residential real estate loan. The dollar amount of the allowance for loan losses increased primarily as a result of an increase in loan balances offset, somewhat, by lower historical loss factors.

During 2015, the Company enhanced its approach to the development of the historical loss factors and qualitative factors used on certain loan portfolios. The methodology enhancement was in response to the changes in the risk characteristics of the Company s new loan originations, as the Company has continued to increase its exposure to larger loan originations to large institutions with strong credit quality. The Company has limited internal loss history experience with these types of loans, and has determined a more appropriate representation of loss expectation is to utilize external historical loss factors based on public credit ratings, as there is a great deal of default and loss data available on these types of loans from the credit rating agencies. As of June 30, 2015, the Company incorporated this information into the development of the historical loss rates for these loan types. The combination of the enhancements made to the allowance methodology to address the changing risk profile of the Company s new loan originations and the increase in these loan types as a percentage of the overall portfolio, has resulted in a decrease in the ratio of allowance for loan losses to total loans for 2015. For 2016 and 2017, the change in the ratio of the allowance for loan losses to loans outstanding, was primarily due to changes in portfolio composition, lower historical loss rates, and qualitative factor adjustments. For 2018, the ratio increased, primarily as a result of changes in qualitative factors related to general economic factors pertaining to certain industries.

In addition, the Company monitors the outlook for the industries in which these institutions operate. Healthcare and higher education are the primary industries. The Company also monitors the volatility of the losses within the historical data.

By combining the credit rating, the industry outlook and the loss volatility, the Company arrives at the quantitative loss factor for each credit grade.

Credit ratings issued by national organizations were utilized as credit quality indicators as presented in the following table at December 31, 2018.

(in thousands)	Commercial and Industrial	Municipal	Commercial Real Estate	Total
Credit Rating:				
Aaa-Aa3	**$ 491,247**	**$ 54,105**	**$ 42,790**	**$ 588,142**
A1-A3	**172,472**	**7,605**	**151,381**	**331,458**
Baa1-Baa3		**26,970**	**118,197**	**145,167**
Ba2		**6,810**		**6,810**

Total	**$ 663,719**	**$ 95,490**	**$ 312,368**	**$ 1,071,577**

28

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

Credit ratings issued by national organizations were utilized as credit quality indicators as presented in the following table at December 31, 2017.

(in thousands)	Commercial and Industrial	Municipal	Commercial Real Estate	Total
Credit Rating:				
Aaa-Aa3	$ 478,905	$ 62,029	$ 45,066	$ 586,000
A1-A3	195,599	7,635	128,554	331,788
Baa1-Baa3		26,970	122,000	148,970
Ba2		8,165		8,165
Total	$ 674,504	$ 104,799	$ 295,620	$ 1,074,923

The allowance for loan losses is an estimate of the amount needed for an adequate reserve to absorb losses in the existing loan portfolio. This amount is determined by an evaluation of the loan portfolio, including input from an independent organization engaged to review selected larger loans, a review of loan experience and current economic conditions. Although the allowance is allocated between categories, the entire allowance is available to absorb losses attributable to all loan categories. At December 31 of each year listed below, the allowance is comprised of the following:

	2018		2017		2016		2015		2014	
(dollars in thousands)	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
Construction and land development	**$ 1,092**	**0.6%**	$ 1,645	0.9%	$ 1,012	0.8%	$ 2,041	1.6%	$ 1,592	1.7%
Commercial and industrial	**10,998**	**33.3%**	9,651	35.1%	6,972	31.8%	5,899	26.1%	4,757	11.2%

Municipal	**1,838**	**4.3%**	1,720	4.9%	1,612	7.1%	994	4.9%	1,488	3.1%
Commercial real estate	**10,663**	**32.8%**	9,728	33.7%	11,135	36.2%	10,589	41.7%	11,199	52.3%
Residential real estate	**2,190**	**15.2%**	1,873	13.2%	1,698	12.5%	1,320	14.7%	776	19.3%
Consumer and other	**365**	**0.9%**	373	0.8%	582	0.6%	644	0.7%	810	1.0%
Home equity	**1,111**	**12.9%**	989	11.4%	1,102	11.0%	1,077	10.3%	599	11.4%
Unallocated	**286**		276		293		511		1,097	
Total	**$ 28,543**	**100.0%**	$ 26,255	100.0%	$ 24,406	100.0%	$ 23,075	100.0%	$ 22,318	100.0%

Management believes that the allowance for loan losses is adequate. In addition, various regulatory agencies, as part of the examination process, periodically review the Company s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. The enhancements described above have resulted in a lower level of unallocated allowance for loan losses. Further information regarding the allocation of the allowance is contained within Note 6 of the Notes to Consolidated Financial Statements.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

Deposits

The Company offers savings accounts, NOW accounts, demand deposits, time deposits and money market accounts. Additionally, the Company offers cash management accounts which provide either automatic transfer of funds above a specified level from the customer s checking account to a money market account or short-term borrowings. Also, an account reconciliation service is offered whereby the Company provides a report balancing the customer s checking account.

Interest rates on deposits are set twice per month by the Bank s rate-setting committee, based on factors including loan demand, maturities and a review of competing interest rates offered. Interest rate policies are reviewed periodically by the Executive Management Committee.

The following table sets forth the average balances of the Bank s deposits for the periods indicated.

	2018		2017		2016	
(dollars in thousands)	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Demand Deposits	**$ 753,604**	**18.5%**	$ 687,853	18.0%	$ 609,159	17.8%
Savings and Interest Checking	**1,514,259**	**37.1%**	1,457,872	38.2%	1,322,714	38.6%
Money Market	**1,230,010**	**30.2%**	1,105,072	28.9%	1,041,404	30.4%
Time Certificates of Deposit	**577,975**	**14.2%**	566,940	14.9%	452,562	13.2%
Total	**$ 4,075,848**	**100.0%**	$ 3,817,737	100.0%	$ 3,425,839	100.0%

Time Deposits of $100,000 or more as of December 31, are as follows:

(dollars in thousands)	**2018**	**2017**
Three months or less	**$ 141,500**	$ 107,649
Three months through six months	**110,189**	137,260
Six months through twelve months	**100,446**	123,468
Over twelve months	**107,182**	135,426
Total	**$ 459,317**	$ 503,803

Borrowings

The Bank s borrowings consisted primarily of Federal Home Loan Bank of Boston (FHLBB) borrowings collateralized by a blanket pledge agreement on the Bank s FHLBB stock, certain qualified investment securities, deposits at the FHLBB and residential mortgages held in the Bank s portfolios. The Bank s borrowings from the FHLBB totaled $202,378,000, a decrease of $145,400,000 from the prior year. The Bank s remaining term borrowing capacity at the FHLBB at December 31, 2018, was approximately $508,861,000. In addition, the Bank has a $14,500,000 line of credit with the FHLBB. See Note 12, Other Borrowed Funds and Subordinated Debentures, for a schedule, including related interest rates and other information.

Subordinated Debentures

In December 2004, the Company consummated the sale of a Trust Preferred Securities offering, in which it issued $36,083,000 of subordinated debt securities due 2034 to its newly formed unconsolidated subsidiary, Century Bancorp Capital Trust II.

Century Bancorp Capital Trust II then issued 35,000 shares of Cumulative Trust Preferred Securities with a liquidation value of $1,000 per share. These securities paid dividends at an annualized rate of 6.65% for the first

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

ten years and then converted to the three-month LIBOR rate plus 1.87% for the remaining 20 years. The coupon rate on these securities was 4.66% at December 31, 2018. The Company is using the proceeds primarily for general business purposes.

Securities Sold Under Agreements to Repurchase

The Bank s remaining borrowings consist primarily of securities sold under agreements to repurchase. Securities sold under agreements to repurchase totaled $154,240,000, a decrease of $4,750,000 from the prior year. See Note 11, Securities Sold Under Agreements to Repurchase, for a schedule, including related interest rates and other information.

RESULTS OF OPERATIONS

Net Interest Income

The Company s operating results depend primarily on net interest income and fees received for providing services. Net interest income on a fully taxable equivalent basis increased 1.8% in 2018 to $101,430,000, compared with $99,595,000 in 2017. The increase in net interest income for 2018 was mainly due to a 5.1% increase in the average balances of earning assets, combined with a similar increase in deposits. The increase in net interest income for 2017 was mainly due to an 8.1% increase in the average balances of earning assets, combined with a similar increase in deposits. The level of interest rates, the ability of the Company s earning assets and liabilities to adjust to changes in interest rates and the mix of the Company s earning assets and liabilities affect net interest income. The net interest margin on a fully taxable equivalent basis decreased to 2.18% in 2018 and increased to 2.25% in 2017 from 2.12% in 2016. The decrease in the net interest margin for 2018 was primarily the result of a decrease in the federal corporate tax rate from 34% to 21% as well as lower prepayment penalties collected during 2018. The decrease in the tax rate results in a lower tax equivalent yield on tax-exempt assets. The increase in the net interest margin for 2017 was primarily attributable to an increase in rates on earning assets and prepayment penalties collected. The Company collected approximately $39,000, $907,000 and $416,000, respectively, of prepayment penalties, which are included in interest income on loans, for 2018, 2017 and 2016, respectively.

Additional information about the net interest margin is contained in the Overview section of this report. Also, there can be no assurance that certain factors beyond its control, such as the prepayment of loans and changes in market interest rates, will continue to positively impact the net interest margin. Management believes that the current yield curve environment will continue to present challenges as deposit and borrowing costs may have the potential to increase at a faster rate than corresponding asset categories.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

The following table sets forth the distribution of the Company s average assets, liabilities and stockholders equity, and average rates earned or paid on a fully taxable equivalent basis for each of the years indicated.

	2018			2017			2016		
ear Ended December 31, dollars in thousands)	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)	Average Balance	Interest Income/ Expense(2)	Rate Earned/ Paid(2)	Average Balance	Interest Income/ Expense(2)	Rate Earned/ Paid(2)
SSETS									
nterest-earning assets:									
oans(3)									
axable	$ 1,102,390	$ 46,615	4.23%	$ 978,593	$ 39,103	4.00%	$ 866,180	$ 34,324	3.96%
ax-exempt	1,120,556	40,439	3.61%	1,081,204	40,420	3.74%	971,956	35,943	3.70%
ecurities vailable-for-sale:(4)									
axable	310,071	7,864	2.54%	354,918	5,859	1.65%	349,023	3,969	1.14%
ax-exempt	90,027	1,938	2.15%	106,717	1,588	1.49%	149,631	1,465	0.98%
ecurities held-to-maturity:									
axable	1,854,328	45,556	2.46%	1,725,280	38,348	2.22%	1,533,032	32,679	2.13%
nterest-bearing deposits in ther banks	183,903	3,498	1.90%	189,193	2,097	1.11%	235,339	1,236	0.53%
otal interest-earning assets	4,661,275	145,910	3.13%	4,435,905	127,415	2.87%	4,105,161	109,616	2.67%
oninterest-earning assets	229,244			221,628			210,203		
llowance for loan losses	(27,531)			(25,329)			(23,872)		
otal assets	$ 4,862,988			$ 4,632,204			$ 4,291,492		
IABILITIES AND STOCKHOLDERS EQUITY									
nterest-bearing deposits:									
OW accounts	$ 926,143	$ 6,579	0.71%	$ 949,924	$ 3,669	0.39%	$ 904,892	$ 2,311	0.26%
avings accounts	588,116	5,178	0.88%	507,948	2,627	0.52%	417,822	1,709	0.41%
oney market accounts	1,230,010	13,922	1.13%	1,105,071	5,626	0.51%	1,041,404	3,542	0.34%
ime deposits	577,975	10,208	1.77%	566,941	7,919	1.40%	452,562	5,706	1.26%
otal interest-bearing eposits	3,322,244	35,887	1.08%	3,129,884	19,841	0.63%	2,816,680	13,268	0.47%

ecurities sold under greements to repurchase	**147,944**	**976**	**0.66%**	189,684	496	0.26%	222,956	472	0.21%
ther borrowed funds and ubordinated debentures	**291,674**	**7,617**	**2.61%**	309,102	7,483	2.42%	357,974	8,877	2.48%
otal interest-bearing abilities	**3,761,862**	**44,480**	**1.18%**	3,628,670	27,820	0.77%	3,397,610	22,617	0.67%
oninterest-bearing abilities									
emand deposits	**753,604**			687,853			609,159		
ther liabilities	**70,020**			60,925			57,602		
otal liabilities	**4,585,486**			4,377,448			4,064,371		
tockholders equity	**277,502**			254,756			227,121		
otal liabilities and tockholders equity	**$ 4,862,988**			$ 4,632,204			$ 4,291,492		
et interest income on a ully taxable equivalent asis		**$ 101,430**			$ 99,595			$ 86,999	
ess taxable equivalent djustment		**(8,854)**			(13,979)			(12,917)	
et interest income		**$ 92,576**			$ 85,616			$ 74,082	
et interest spread			**1.95%**			2.11%			2.00%
et interest margin			**2.18%**			2.25%			2.12%

(1) On a fully taxable equivalent basis calculated using a federal tax rate of 21%.
(2) On a fully taxable equivalent basis calculated using a federal tax rate of 34%.

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

(3) Nonaccrual loans are included in average amounts outstanding.
(4) At amortized cost.

The following table summarizes the year-to-year changes in the Company s net interest income resulting from fluctuations in interest rates and volume changes in earning assets and interest-bearing liabilities. Changes due to rate are computed by multiplying the change in rate by the prior year s volume. Changes due to volume are computed by multiplying the change in volume by the prior year s rate. Changes in volume and rate that cannot be separately identified have been allocated in proportion to the relationship of the absolute dollar amounts of each change.

Year Ended December 31, (dollars in thousands)	2018 Compared with 2017 Increase/(Decrease) Due to Change in Volume	Rate	Total	2017 Compared with 2016 Increase/(Decrease) Due to Change in Volume	Rate	Total
Interest income:						
Loans						
Taxable	**$ 5,144**	**$ 2,368**	**$ 7,512**	$ 4,490	$ 289	$ 4,779
Tax-exempt	**1,445**	**(1,426)**	**19**	4,080	397	4,477
Securities available-for-sale:						
Taxable	**(816)**	**2,821**	**2,005**	68	1,822	1,890
Tax-exempt	**(277)**	**627**	**350**	(498)	621	123
Securities held-to-maturity:						
Taxable	**2,994**	**4,214**	**7,208**	4,229	1,440	5,669
Interest-bearing deposits in other banks	**(61)**	**1,462**	**1,401**	(283)	1,144	861
Total interest income	**8,429**	**10,066**	**18,495**	12,086	5,713	17,799
Interest expense:						
Deposits:						
NOW accounts	**(94)**	**3,004**	**2,910**	120	1,238	1,358
Savings accounts	**468**	**2,083**	**2,551**	412	506	918
Money market accounts	**702**	**7,594**	**8,296**	228	1,856	2,084
Time deposits	**157**	**2,132**	**2,289**	1,551	662	2,213
Total interest-bearing deposits	**1,233**	**14,813**	**16,046**	2,311	4,262	6,573
Securities sold under agreements to repurchase	**(130)**	**610**	**480**	(77)	101	24
Other borrowed funds and subordinated debentures	**(437)**	**571**	**134**	(1,187)	(207)	(1,394)

Total interest expense	**666**	**15,994**	**16,660**	1,047	4,156	5,203
Change in net interest income	**$ 7,763**	**$ (5,928)**	**$ 1,835**	$ 11,039	$ 1,557	$ 12,596

Average earning assets were $4,661,275,000 in 2018, an increase of $225,370,000 or 5.1% from the average in 2017, which was 8.1% higher than the average in 2016. Total average securities, including securities available-for-sale and securities held-to-maturity, were $2,254,426,000, an increase of 3.1% from the average in 2017. The increase in securities volume was mainly attributable to an increase in taxable securities held-to-maturity. An increase in securities volume and short term rates resulted in higher securities income,

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

which increased 20.9% to $55,358,000 on a fully tax equivalent basis. Total average loans increased 7.9% to $2,222,946,000 after increasing $221,661,000 in 2017. The primary reason for the increase in loans was due in large part to an increase in taxable residential mortgage and commercial lending and tax-exempt lending. The increase in loan volume resulted in higher loan income. Loan income increased by 9.5% or $7,531,000 to $87,054,000 in 2018 compared to 2017. This was mainly the result of an increase in average balances. Loan income also benefited from an increase in rates. Also, there was a decrease in rates earned on tax exempt lending. This was primarily attributable to the decrease in the federal tax rate which lowers the tax equivalent yield. Total loan income was $70,267,000 in 2016.

The Company s sources of funds include deposits and borrowed funds. On average, deposits increased 6.8%, or $258,111,000, in 2018 after increasing by 11.4%, or $391,898,000, in 2017. Deposits increased in 2018, primarily as a result of increases in time deposits, savings, demand deposits, and money market accounts. Deposits increased in 2017, primarily as a result of increases in time deposits, savings, demand deposits, money market, and NOW accounts. Borrowed funds and subordinated debentures decreased by 11.9% in 2018, following a decrease of 14.1% in 2017. The majority of the Company s borrowed funds are borrowings from the FHLBB and retail repurchase agreements. Average borrowings from the FHLBB decreased by approximately $17,428,000, and average retail repurchase agreements decreased by $41,740,000 in 2018. Interest expense totaled $44,480,000 in 2018, an increase of $16,660,000, or 59.9%, from 2017 when interest expense increased 23.0% from 2016. The increase in interest expense, for 2018, is primarily due to increases in the rates on deposits as well as an increase in average balances of deposits. The increase in interest expense, for 2017, is primarily due to increases in the rates on deposits as well as an increase in average balances of deposits offset, somewhat, by a decrease in borrowed funds.

Provision for Loan Losses

The provision for loan losses was $1,350,000 in 2018, compared with $1,790,000 in 2017 and $1,375,000 in 2016. These provisions are the result of management s evaluation of the amounts and credit quality of the loan portfolio considering such factors as loan status, collateral values, financial condition of the borrower, the state of the economy and other relevant information. The provision for loan losses decreased during 2018, primarily as a result of net recoveries of $938,000 offset by changes in qualitative factors. The provision for loan losses increased during 2017, primarily as a result of an increase in loan balances offset, somewhat, by changes in historical loss factors.

Other Operating Income

During 2018, the Company continued to experience strong results in its fee-based services, including fees derived from traditional banking activities such as deposit-related services, its automated lockbox collection system and full-service securities brokerage supported by LPL Financial, a full-service securities brokerage business.

Under the lockbox program, which is not tied to extensions of credit by the Company, the Company s customers arrange for payments of their accounts receivable to be made directly to the Company. The Company records the amounts paid to its customers, deposits the funds to the customer s account and provides automated records of the transactions to customers. Typical customers for the lockbox service are municipalities that use it to automate tax collections, cable TV companies, utilities, and other commercial enterprises.

Through a program called Investment Services at Century Bank, the Bank provides full-service securities brokerage services supported by LPL Financial, a full-service securities brokerage business. Registered representatives employed by Century Bank offer limited investment advice, execute transactions and assist customers in financial and retirement planning. LPL Financial provides research to the Bank s representatives. The Bank receives a share in the commission revenues.

Total other operating income in 2018 was $16,248,000, a decrease of $304,000, or 1.9%, compared to 2017. This decrease followed an increase of $330,000, or 2.0%, in 2017, compared to 2016. Included in other operating income are net gains on sales of securities of $302,000, $47,000 and $64,000 in 2018, 2017 and 2016, respectively. Also included in other operating income are net gains on sales of mortgage loans of $0, $370,000 and $1,331,000 in 2018, 2017 and 2016, respectively. Service charge income, which continues to be a major source of other operating income, totaling $8,560,000 in 2018, decreased $26,000 compared to 2017. This followed an increase of $679,000 in 2017 compared to 2016. The decrease in fees, in 2018, was mainly attributable to an increase earnings credit rates that are used to offset fees collected from processing activities, this was offset somewhat by an increase in debit card fees. The increase in fees, in 2017, was mainly attributable to an increase in fees collected from processing activities and debit card fees. Lockbox revenues totaled $3,274,000, down $16,000 in 2018 following an increase of $126,000 in 2017. Other income totaled $3,764,000, down $142,000 in 2018 following an increase of $465,000 in 2017. The decrease in 2018 was primarily the result of decreases in the returns on life insurance policies offset, somewhat by increase in wealth management fees, and merchant card sales royalties. The increase in 2017 was primarily the result of increases in wealth management fees and merchant card sales royalties.

Operating Expenses

Total operating expenses were $69,693,000 in 2018, compared to $67,119,000 in 2017 and $64,757,000 in 2016.

Salaries and employee benefits expenses increased by $2,193,000 or 5.4% in 2018, after increasing by 5.2% in 2017. The increase in 2018 was mainly attributable to merit increases in salaries. The increase in 2017 was mainly attributable to merit increases in salaries and bonus, and health insurance costs.

Occupancy expense decreased by $48,000, or 0.8%, in 2018, following a decrease of $7,000, or 0.1%, in 2017. The decrease in 2018 was primarily attributable to a decrease in depreciation expense. The decrease in 2017 was primarily attributable to a decrease in rent expense.

Equipment expense increased by $240,000, or 8.3%, in 2018, following an increase of $47,000, or 1.7%, in 2017. The increase in 2018 was primarily attributable to an increase in depreciation expense. The increase in 2017 was primarily attributable to an increase in service contracts.

FDIC assessments decreased by $110,000, or 7.0%, in 2018, following a decrease of $321,000, or 16.9%, in 2017. FDIC assessments decreased in 2018 and 2017 mainly as a result of a decrease in the assessment rate.

Other operating expenses increased by $299,000 in 2018, which followed a $642,000 increase in 2017. The increase in 2018 was primarily attributable to an increase in consultants expense and software maintenance expense. The increase in 2017 was primarily attributable to an increase in contributions, legal expenses, and marketing expenses.

Provision for Income Taxes

Income tax expense was $1,568,000 in 2018, $10,958,000 in 2017, and $(362,000) in 2016. The effective tax rate was 4.2% in 2018, 32.9% in 2017, and (1.5%) in 2016. The decrease for 2018 was primarily as a result of a reduction in the value of its net deferred tax asset resulting in a charge of $8,448,000 to 2017 income tax expense as a result of the Tax Act as previously discussed. The increase in the effective tax rate for 2017 was primarily the result of a reduction in the value of the deferred tax asset resulting in a charge of $8,448,000 to income tax expense. On December 22, 2017, the Tax Act was enacted, which lowered the Company s federal tax rate from 34% to 21%. As a result of the rate reduction, the Company recorded a reduction in the value of its net deferred tax asset. The federal tax rate was 21% in 2018, and 34% in 2017 and 2016.

Market Risk and Asset Liability Management

Market risk is the risk of loss from adverse changes in market prices and rates. The Company s market risk arises primarily from interest rate risk inherent in its lending and deposit-taking activities. To that end, management actively monitors and manages its interest rate risk exposure.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

The Company s profitability is affected by fluctuations in interest rates. A sudden and substantial change in interest rates may adversely impact the Company s earnings to the extent that the interest rates borne by assets and liabilities do not change at the same speed, to the same extent or on the same basis. The Company monitors the impact of changes in interest rates on its net interest income using several tools. One measure of the Company s exposure to differential changes in interest rates between assets and liabilities is an interest rate risk management test.

This test measures the impact on net interest income of an immediate change in interest rates in 100-basis point increments as set forth in the following table:

Change in Interest Rates (in Basis Points)	Percentage Change in Net Interest Income(1)
+400	(8.4)
+300	(6.5)
+200	(5.0)
+100	(2.4)
100	2.1
200	2.0

(1) The percentage change in this column represents net interest income for 12 months in various rate scenarios versus the net interest income in a stable interest rate environment.

The changes in the table above are within the Company s policy parameters.

The Company s primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on the Company s net interest income and capital, while structuring the Company s asset-liability structure to obtain the maximum yield-cost spread on that structure. The Company relies primarily on its asset-liability structure to control interest rate risk.

Liquidity and Capital Resources

Liquidity is provided by maintaining an adequate level of liquid assets that includes cash and due from banks, federal funds sold and other temporary investments. Liquid assets totaled $342,503,000 on December 31, 2018, compared with $356,430,000 on December 31, 2017. In each of these two years, deposit and borrowing activity has generally been adequate to support asset activity.

The sources of funds for dividends paid by the Company are dividends received from the Bank and liquid funds held by the Company. The Company and the Bank are regulated enterprises and their abilities to pay dividends are subject to regulatory review and restriction. Certain regulatory and statutory restrictions exist regarding dividends, loans and advances from the Bank to the Company. Generally, the Bank has the ability to pay dividends to the Company subject to minimum regulatory capital requirements.

Capital Adequacy

Total stockholders equity was $300,439,000 at December 31, 2018, compared with $260,297,000 at December 31, 2017. The Company s equity increased primarily as a result of earnings and a decrease in other comprehensive loss, net of taxes, offset somewhat by dividends paid. Other comprehensive loss, net of taxes, decreased primarily as a result of a decrease in unrealized losses on securities transferred from available-for-sale to held-to-maturity, a decrease in unrealized losses on securities available-for-sale, and a decrease in the pension liability, net of taxes.

Table of Contents

Management s Discussion and Analysis of Results of Operations and Financial Condition (Continued)

Federal banking regulators have issued risk-based capital guidelines, which assign risk factors to asset categories and off-balance-sheet items. The following table reflects capital ratios computed utilizing the recently implemented Basel III regulatory capital framework:

	Minimum Capital Ratios	Bank	Company
Leverage ratios	**4.00%**	**6.68%**	**6.91%**
Common equity tier 1 risk weighted capital ratios	**4.50%**	**12.21%**	**11.32%**
Tier 1 risk weighted capital ratios	**6.00%**	**12.21%**	**12.59%**
Total risk weighted capital ratios	**8.00%**	**13.24%**	**13.62%**

Contractual Obligations, Commitments, and Contingencies

The Company has entered into contractual obligations and commitments. The following tables summarize the Company s contractual cash obligations and other commitments at December 31, 2018.

Contractual Obligations and Commitments by Maturity (dollars in thousands)

		Payments Due By Period			
CONTRACTUAL OBLIGATIONS	**Total**	**Less Than One Year**	**One to Three Years**	**Three to Five Years**	**After Five Years**
FHLBB advances	**$ 202,378**	**$ 63,000**	**$ 53,000**	**$ 33,500**	**$ 52,878**
Subordinated debentures	**36,083**				**36,083**
Retirement benefit obligations	**50,610**	**3,971**	**8,430**	**9,152**	**29,057**
Lease obligations	**9,863**	**2,490**	**3,864**	**2,435**	**1,074**
Customer repurchase agreements	**154,240**	**154,240**			
Total contractual cash obligations	**$ 453,174**	**$ 223,701**	**$ 65,294**	**$ 45,087**	**$ 119,092**

		Amount of Commitment Expiring By Period			
OTHER COMMITMENTS	**Total**	**Less Than One Year**	**One to Three Years**	**Three to Five Years**	**After Five Years**
Lines of credit	**$ 553,045**	**$ 84,608**	**$ 59,064**	**$ 91,426**	**$ 317,947**

Standby and commercial letters of credit	**4,258**	**3,459**	**512**	**236**	**51**
Other commitments	**54,126**	**10,626**	**6,217**	**2,327**	**34,956**
Total commitments	**$ 611,429**	**$ 98,693**	**$ 65,793**	**$ 93,989**	**$ 352,954**

Financial Instruments with Off-Balance-Sheet Risk

The Company 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 primarily include commitments to originate and sell loans, standby letters of credit, unused lines of credit and unadvanced portions of construction loans. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in these particular classes of financial instruments.

The Company s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments, standby letters of credit and unadvanced portions of construction loans is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Financial instruments with off-balance-sheet risk at December 31 are as follows:

Contract or Notional Amount	2018	2017
(dollars in thousands)		
Financial instruments whose contract amount represents credit risk:		
Commitments to originate 1 4 family mortgages	$ 5,075	$ 5,748
Standby and commercial letters of credit	4,258	5,520
Unused lines of credit	553,045	434,618
Unadvanced portions of construction loans	28,746	15,152
Unadvanced portions of other loans	20,305	35,602

Commitments to originate loans, unadvanced portions of construction loans and unused letters of credit are generally agreements to lend to a customer, provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the borrower.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The fair value of standby letters of credit was $51,000 and $66,000 for 2018 and 2017, respectively.

Recent Accounting Developments

See Note 1 to the Notes to Consolidated Financial Statements for details of recent accounting developments and their expected impact on the Company s financial statements.

Table of Contents

Consolidated Balance Sheets

December 31, (dollars in thousands except share data)	2018	2017
ASSETS		
Cash and due from banks (Note 2)	**$ 89,540**	$ 77,199
Federal funds sold and interest-bearing deposits in other banks	**252,963**	279,231
Total cash and cash equivalents	**342,503**	356,430
Securities available-for-sale, amortized cost $336,751 in 2018 and $395,947 in 2017 (Notes 3, 9 and 11)	**336,759**	395,830
Securities held-to-maturity, fair value $1,991,421 in 2018 and $1,668,827 in 2017 (Notes 4 and 11)	**2,046,647**	1,701,233
Federal Home Loan Bank of Boston, stock at cost	**17,974**	21,779
Equity securities, amortized cost $1,635 in 2018 and $1,616 in 2017, respectively	**1,596**	1,663
Loans, net (Note 5)	**2,285,578**	2,175,944
Less: allowance for loan losses (Note 6)	**28,543**	26,255
Net loans	**2,257,035**	2,149,689
Bank premises and equipment (Note 7)	**23,921**	23,527
Accrued interest receivable	**14,406**	11,179
Other assets (Notes 5, 6, 8 and 16)	**123,094**	124,242
Total assets	**$ 5,163,935**	$ 4,785,572
LIABILITIES AND STOCKHOLDERS EQUITY		
Demand deposits	**$ 813,478**	$ 736,020
Savings and NOW deposits	**1,707,019**	1,367,358
Money market accounts	**1,325,888**	1,188,228
Time deposits (Note 10)	**560,579**	625,361
Total deposits	**4,406,964**	3,916,967
Securities sold under agreements to repurchase (Note 11)	**154,240**	158,990
Other borrowed funds (Note 12)	**202,378**	347,778
Subordinated debentures (Note 12)	**36,083**	36,083
Other liabilities	**63,831**	65,457
Total liabilities	**4,863,496**	4,525,275
Commitments and contingencies (Notes 7, 18 and 19)		
Stockholders equity (Note 15):		
Preferred Stock $1.00 par value; 100,000 shares authorized; no shares issued and outstanding		
Common stock, Class A,		
$1.00 par value per share; authorized 10,000,000 shares; issued 3,608,329 shares in 2018 and 3,605,829 shares in 2017	**3,608**	3,606

Common stock, Class B,		
$1.00 par value per share; authorized 5,000,000 shares; issued 1,959,580 in 2018 and 1,962,080 shares in 2017	**1,960**	1,962
Additional paid-in capital	**12,292**	12,292
Retained earnings	**301,488**	263,666
	319,348	281,526
Unrealized gain (losses) on securities available-for-sale, net of taxes	**6**	(62)
Unrealized losses on securities transferred to held-to-maturity, net of taxes	**(2,565)**	(3,050)
Pension liability, net of taxes	**(16,350)**	(18,117)
Total accumulated other comprehensive loss, net of taxes (Notes 3, 13 and 15)	**(18,909)**	(21,229)
Total stockholders equity	**300,439**	260,297
Total liabilities and stockholders equity	**$ 5,163,935**	$ 4,785,572

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Consolidated Statements of Income

Year Ended December 31, (dollars in thousands except share data)	2018	2017	2016
INTEREST INCOME			
Loans, taxable	**$ 46,615**	$ 39,103	$ 34,324
Loans, non-taxable	**31,936**	26,910	23,440
Securities available-for-sale, taxable	**6,748**	4,987	3,003
Securities available-for-sale, non-taxable	**1,587**	1,119	1,051
Federal Home Loan Bank of Boston dividends	**1,116**	872	966
Securities held-to-maturity	**45,556**	38,348	32,679
Federal funds sold, interest-bearing deposits in other banks and short-term investments	**3,498**	2,097	1,236
Total interest income	**137,056**	113,436	96,699
INTEREST EXPENSE			
Savings and NOW deposits	**11,757**	6,296	4,020
Money market accounts	**13,922**	5,626	3,542
Time deposits	**10,208**	7,919	5,706
Securities sold under agreements to repurchase	**976**	496	472
Other borrowed funds and subordinated debentures	**7,617**	7,483	8,877
Total interest expense	**44,480**	27,820	22,617
Net interest income	**92,576**	85,616	74,082
Provision for loan losses (Note 6)	**1,350**	1,790	1,375
Net interest income after provision for loan losses	**91,226**	83,826	72,707
OTHER OPERATING INCOME			
Service charges on deposit accounts	**8,560**	8,586	7,907
Lockbox fees	**3,274**	3,290	3,164
Brokerage commissions	**348**	353	315
Net gains on sales of securities	**302**	47	64
Gains on sales of mortgage loans		370	1,331
Other income	**3,764**	3,906	3,441
Total other operating income	**16,248**	16,552	16,222
OPERATING EXPENSES			
Salaries and employee benefits (Note 17)	**42,710**	40,517	38,516
Occupancy	**6,092**	6,140	6,147
Equipment	**3,132**	2,892	2,845
FDIC assessments	**1,471**	1,581	1,902
Other (Note 20)	**16,288**	15,989	15,347
Total operating expenses	**69,693**	67,119	64,757

Income before income taxes		**37,781**		33,259		24,172
Provision for income taxes (Note 16)		**1,568**		10,958		(362)
Net income	**$**	**36,213**	$	22,301	$	24,534
SHARE DATA (Note 14)						
Weighted average number of shares outstanding, basic						
Class A		**3,608,179**		3,604,029		3,600,729
Class B		**1,959,730**		1,963,880		1,967,180
Weighted average number of shares outstanding, diluted						
Class A		**5,567,909**		5,567,909		5,567,909
Class B		**1,959,730**		1,963,880		1,967,180
Basic earnings per share						
Class A	**$**	**7.89**	$	4.86	$	5.35
Class B	**$**	**3.95**	$	2.43	$	2.68
Diluted earnings per share						
Class A	**$**	**6.50**	$	4.01	$	4.41
Class B	**$**	**3.95**	$	2.43	$	2.68

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Consolidated Statements of Comprehensive Income

Year Ended December 31, (dollars in thousands)	**2018**	**2017**	**2016**
NET INCOME	**$ 36,213**	$ 22,301	$ 24,534
Other comprehensive income (loss), net of tax:			
Unrealized gains (losses) on securities:			
Unrealized holding gains (losses) arising during period	**326**	533	(289)
Less: reclassification adjustment for gains included in net income	**(217)**	(28)	(32)
Total unrealized gains (losses) on securities	**109**	505	(321)
Accretion of net unrealized losses transferred during period	**1,086**	1,034	2,812
Defined benefit pension plans:			
Pension liability adjustment:			
Net (loss) gain	**3,770**	(2,315)	(297)
Amortization of prior service cost and loss included in net periodic benefit cost	**1,167**	931	970
Total pension liability adjustment	**4,937**	(1,384)	673
Other comprehensive income	**6,132**	155	3,164
Comprehensive income (loss)	**$ 42,345**	$ 22,456	$ 27,698

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Consolidated Statements of Changes in Stockholders Equity

(dollars in thousands except share data)	Class A Common Stock	Class B Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
BALANCE, DECEMBER 31, 2015	$ 3,601	$ 1,967	$ 12,292	$ 221,232	$ (24,548)	$ 214,544
Net income				24,534		24,534
Other comprehensive income, net of tax:						
Unrealized holding gains arising during period, net of $248 in taxes and $52 in realized net gains					(321)	(321)
Accretion of net unrealized losses transferred during the period, net of $1,505 in taxes					2,812	2,812
Pension liability adjustment, net of $448 in taxes					673	673
Cash dividends, Class A Common Stock, $0.48 per share				(1,729)		(1,729)
Cash dividends, Class B Common Stock, $0.24 per share				(472)		(472)
BALANCE, DECEMBER 31, 2016	$ 3,601	$ 1,967	$ 12,292	$ 243,565	$ (21,384)	$ 240,041
Net income				22,301		22,301
Other comprehensive income, net of tax:						
Unrealized holding gains arising during period, net of $331 in taxes and $47 in realized net gains					505	505
Accretion of net unrealized losses transferred during the period, net of $1,258 in taxes					1,034	1,034
Pension liability adjustment, net of $286 in taxes					(1,384)	(1,384)
Conversion of Class B Common Stock to Class A Common Stock, 5,100 shares	5	(5)				
Cash dividends, Class A Common Stock, $0.48 per share				(1,729)		(1,729)

Cash dividends, Class B Common Stock, $0.24 per share				(471)		(471)
BALANCE, DECEMBER 31, 2017	$ 3,606	$ 1,962	$ 12,292	$ 263,666	$ (21,229)	$ 260,297
Net income				**36,213**		**36,213**
Other comprehensive income, net of tax:						
Unrealized holding gains arising during period, net of $16 in taxes and $302 in realized net gains					**109**	**109**
Accretion of net unrealized losses transferred during the period, net of $391 in taxes					**1,086**	**1,086**
Pension liability adjustment, net of $1,930 in taxes					**4,937**	**4,937**
Adoption of ASU 2018-2, Income Statement-Reporting Comprehensive Income (Topic 220)-Reclassification of Certain Tax Effects from AOCI				**3,783**	**(3,783)**	
Adoption of ASU 2016-1, Financial Instruments-Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities				**29**	**(29)**	
Conversion of Class B Common Stock to Class A Common Stock, 2,500 shares	**2**	**(2)**				
Cash dividends, Class A Common Stock, $0.48 per share				**(1,732)**		**(1,732)**
Cash dividends, Class B Common Stock, $0.24 per share				**(471)**		**(471)**
BALANCE, DECEMBER 31, 2018	**$ 3,608**	**$ 1,960**	**$ 12,292**	**$ 301,488**	**$ (18,909)**	**$ 300,439**

See accompanying Notes to Consolidated Financial Statements.

42

Table of Contents

Consolidated Statements of Cash Flows

Year Ended December 31, (dollars in thousands)	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	**$ 36,213**	$ 22,301	$ 24,534
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on sales of portfolio loans		(370)	(1,331)
Gain on sale of fixed assets		(11)	
Net gains on sales of securities	**(302)**	(47)	(64)
Net loss on equity securities	**67**		
Provision for loan losses	**1,350**	1,790	1,375
Deferred tax (expense)benefit	**(1,766)**	6,918	(4,676)
Net depreciation and amortization	**885**	3,047	3,561
Increase in accrued interest receivable	**(3,227)**	(1,534)	(1,643)
Increase in other assets	**2,326**	(16,310)	(2,953)
Increase in other liabilities	**5,242**	5,802	3,203
Net cash provided by operating activities	**40,788**	21,586	22,006
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturities of short-term investments		5,284	3,233
Purchase of short-term investments		(2,101)	(3,183)
Proceeds from redemptions of Federal Home Loan Bank of Boston stock	**18,388**	10,127	10,381
Purchase of Federal Home Loan Bank of Boston stock	**(14,583)**	(10,864)	(2,616)
Proceeds from calls/maturities of securities available-for-sale	**215,406**	259,388	277,657
Proceeds from sales of securities available-for-sale	**27,517**	18,180	2,376
Purchase of securities available-for-sale	**(183,588)**	(175,147)	(375,608)
Proceeds from calls/maturities of securities held-to-maturity	**234,741**	293,221	416,599
Proceeds from sales of securities held-to-maturity			192
Purchase of securities held-to-maturity	**(576,140)**	(337,773)	(627,670)
Proceeds from life insurance policies	**375**	115	
Proceeds from sales of portfolio loans		26,701	74,668
Net increase in loans	**(110,874)**	(278,242)	(265,732)
Proceeds from sales of fixed assets		11	
Capital expenditures	**(3,601)**	(3,244)	(2,263)
Net cash used in investing activities	**(392,359)**	(194,344)	(491,966)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease) increase in time deposit accounts	**(64,782)**	147,002	4,933
Net increase in demand, savings, money market and NOW deposits	**554,779**	116,747	573,225
Cash dividends	**(2,203)**	(2,200)	(2,201)
Net decrease in securities sold under agreements to repurchase	**(4,750)**	(23,290)	(15,570)
Net (decrease) increase in other borrowed funds	**(145,400)**	54,778	(75,000)

Net cash provided by financing activities	**337,644**	293,037	485,387
Net (decrease) increase in cash and cash equivalents	**(13,927)**	120,279	15,427
Cash and cash equivalents at beginning of year	**356,430**	236,151	220,724
Cash and cash equivalents at end of year	**$ 342,503**	$ 356,430	$ 236,151
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	**$ 44,289**	$ 27,731	$ 22,668
Income taxes	**$ 590**	$ 5,330	$ 3,730
Change in unrealized gains on securities available-for-sale, net of taxes	**$ 109**	$ 505	$ (321)
Change in unrealized losses on securities transferred to held-to-maturity, net of taxes	**$ 1,086**	$ 1,034	$ 2,812
Pension liability adjustment, net of taxes	**$ 4,937**	$ (1,384)	$ 673
Transfer of loans to other real estate owned	**$ 2,225**	$	$

See accompanying Notes to Consolidated Financial Statements.

43

Table of Contents

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

BASIS OF FINANCIAL STATEMENT PRESENTATION

The consolidated financial statements include the accounts of Century Bancorp, Inc. (the Company) and its wholly owned subsidiary, Century Bank and Trust Company (the Bank). The consolidated financial statements also include the accounts of the Bank s wholly owned subsidiaries, Century Subsidiary Investments, Inc. (CSII), Century Subsidiary Investments, Inc. II (CSII II), Century Subsidiary Investments, Inc. III (CSII III) and Century Financial Services Inc. (CFSI). CSII, CSII II, and CSII III are engaged in buying, selling and holding investment securities. CFSI has the power to engage in financial agency, securities brokerage, and investment and financial advisory services and related securities credit. The Company also owns 100% of Century Bancorp Capital Trust II (CBCT II). The entity is an unconsolidated subsidiary of the Company.

All significant intercompany accounts and transactions have been eliminated in consolidation. The Company provides a full range of banking services to individual, business and municipal customers in Massachusetts, New Hampshire, Rhode Island, Connecticut and New York. As a bank holding company, the Company is subject to the regulation and supervision of the Federal Reserve Board. The Bank, a state chartered financial institution, is subject to supervision and regulation by applicable state and federal banking agencies, including the Federal Reserve Board, the Federal Deposit Insurance Corporation (the FDIC) and the Commonwealth of Massachusetts Commissioner of Banks. The Bank is also subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that may be charged thereon, and limitations on the types of investments that may be made and the types of services that may be offered. Various consumer laws and regulations also affect the operations of the Bank. In addition to the impact of regulation, commercial banks are affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to influence the economy. All aspects of the Company s business are highly competitive. The Company faces aggressive competition from other lending institutions and from numerous other providers of financial services. The Company has one reportable operating segment.

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and general practices within the banking industry. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates.

Material estimates that are susceptible to change in the near term relate to the allowance for loan losses. Management believes that the allowance for loan losses is adequate based on a review of factors, including historical charge-off rates with additional allocations based on qualitative risk factors for each category and general economic factors. While management uses available information to recognize loan losses, future additions to the allowance for loan losses may be necessary based on changes in economic conditions. In addition, regulatory agencies periodically review the Company s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination. Certain reclassifications are made to prior-year amounts whenever necessary to conform with the current-year presentation.

FAIR VALUE MEASUREMENTS

The Company follows FASB ASC 820-10, *Fair Value Measurements and Disclosures,* which among other things, requires enhanced disclosures about assets and liabilities carried at fair value. ASC 820-10 establishes a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The three broad levels of the hierarchy are as follows:

Level I Quoted prices are available in active markets for identical assets or liabilities as of the reported date. The type of financial instruments included in Level I are highly liquid cash instruments with quoted prices, such as G-7 government, agency securities, listed equities and money market securities, as well as listed derivative instruments.

Table of Contents

Notes to Consolidated Financial Statements (Continued)

Level II Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these financial instruments includes cash instruments for which quoted prices are available but traded less frequently, derivative instruments whose fair value has been derived using a model where inputs to the model are directly observable in the market or can be derived principally from or corroborated by observable market data, and instruments that are fair valued using other financial instruments, the parameters of which can be directly observed. Instruments that are generally included in this category are corporate bonds and loans, mortgage whole loans, municipal bonds and over the counter (OTC) derivatives.

Level III These instruments have little to no pricing observability as of the reported date. These financial instruments do not have two-way markets and are measured using management s best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation. Instruments that are included in this category generally include certain commercial mortgage loans, certain private equity investments, distressed debt, and noninvestment grade residual interests in securitizations as well as certain highly structured OTC derivative contracts.

CASH AND CASH EQUIVALENTS

For purposes of reporting cash flows, cash equivalents include highly liquid assets with an original maturity of three months or less. Highly liquid assets include cash and due from banks, federal funds sold and certificates of deposit.

SHORT-TERM INVESTMENTS

As of December 31, 2018 and 2017, short-term investments include highly liquid certificates of deposit with original maturities of more than 90 days but less than one year.

INVESTMENT SECURITIES

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost; debt securities that are bought and held principally for the purpose of selling are classified as trading and reported at fair value, with unrealized gains and losses included in earnings; and debt securities not classified as either held-to-maturity or trading are classified as available-for-sale and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders equity, net of estimated related income taxes. Equity securities are reported at fair value with unrealized gains and losses included in earnings. The Company has no securities held for trading.

Premiums and discounts on investment securities are amortized or accreted into income by use of the level-yield method. Gains and losses on the sale of investment securities are recognized on the trade date on a specific identification basis.

Management also considers the Company s capital adequacy, interest-rate risk, liquidity and business plans in assessing whether it is more likely than not that the Company will sell or be required to sell the investment securities before recovery. Other-than-temporary-impairment (OTTI) arises when a security s fair value is less than its amortized cost and, based on specific factors, the loss is considered OTTI. If the Company determines that a decline in fair value is OTTI and that it is more likely than not that the Company will not sell or be required to sell the investment security before recovery of its amortized cost, the credit portion of the impairment loss is recognized in the Company s consolidated statement of income and the noncredit portion is recognized in accumulated other comprehensive income. The credit portion of the OTTI impairment represents the difference between the amortized cost and the present value of the expected future cash flows of the investment security. If the Company determines that a decline in fair value is OTTI and it is more likely than not that it will sell or be required to sell the investment security before recovery of its amortized cost, the entire difference between the amortized cost and the fair value of the security will be recognized in the Company s consolidated statement of income.

The transfer of a security between categories of investments shall be accounted for at fair value. For a debt security transferred into the held-to-maturity category from the available-for-sale category, the unrealized

Notes to Consolidated Financial Statements (Continued)

holding gain or loss at the date of the transfer shall continue to be reported in a separate component of shareholders equity but shall be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount. The amortization of an unrealized holding gain or loss reported in equity will offset or mitigate the effect on interest income of the amortization of the premium or discount for that held-to-maturity security.

The sale of a security held-to-maturity may occur after a substantial portion (at least 85%) of the principal outstanding at acquisition due either to prepayments on the debt security or to scheduled payments on a debt security payable in equal installments over its term. For variable rate securities, the scheduled payments need not be equal.

FEDERAL HOME LOAN BANK STOCK

The Bank, as a member of the Federal Home Loan Bank of Boston (FHLBB), is required to maintain an investment in capital stock of the FHLBB. Based on redemption provisions, the stock has no quoted market value and is carried at cost. At its discretion, the FHLBB may declare dividends on the stock. The Company reviews for impairment based on the ultimate recoverability of the cost basis of the stock. As of December 31, 2018, no impairment has been recognized.

LOANS HELD FOR SALE

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

LOANS

Interest on loans is recognized based on the daily principal amount outstanding. Accrual of interest is discontinued when loans become ninety days delinquent unless the collateral is sufficient to cover both principal and interest and the loan is in the process of collection. Past-due status is based on contractual terms of the loan. Loans, including impaired loans, on which the accrual of interest has been discontinued, are designated nonaccrual loans. When a loan is placed on nonaccrual, all income that has been accrued but remains unpaid is reversed against current period income, and all amortization of deferred loan costs and fees is discontinued. Nonaccrual loans may be returned to an accrual status when principal and interest payments are not delinquent or the risk characteristics of the loan have improved to the extent that there no longer exists a concern as to the collectibility of principal and interest. Income received on nonaccrual loans is either recorded in income or applied to the principal balance of the loan, depending on management s evaluation as to the collectibility of principal.

Loan origination fees and related direct loan origination costs are offset, and the resulting net amount is deferred and amortized over the life of the related loans using the level-yield method. Prepayments are not initially considered when amortizing premiums and discounts.

The Bank measures impairment for impaired loans at either the fair value of the loan, the present value of the expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if the loan is collateral dependent. This method applies to all loans, uncollateralized as well as collateralized, except large groups of smaller-balance homogeneous loans such as residential real estate and consumer loans that are collectively evaluated for impairment and loans that are measured at fair value. For collateral dependent loans, the amount of the recorded investment in a loan that exceeds the fair value of the collateral is charged-off against the allowance for loan losses in lieu of an allocation of a specific allowance when such an amount has been identified definitively as uncollectible. Management considers the payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms. Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Loans are charged-off when management believes that the

Notes to Consolidated Financial Statements (Continued)

collectibility of the loan s principal is not probable. The specific factors that management considers in making the determination that the collectibility of the loan s principal is not probable include the delinquency status of the loan, the fair value of the collateral, if secured, and, the financial strength of the borrower and/or guarantors. In addition, criteria for classification of a loan as in-substance foreclosure has been modified so that such classification need be made only when a lender is in possession of the collateral. The Bank measures the impairment of troubled debt restructurings using the pre-modification effective rate of interest.

TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets, typically residential mortgages and loan participations for the Company, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets.

ACQUIRED LOANS

In accordance with FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (formerly Statement of Position (SOP) No. 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer) the Company reviews acquired loans for differences between contractual cash flows and cash flows expected to be collected from the Company s initial investment in the acquired loans to determine if those differences are attributable, at least in part, to credit quality. If those differences are attributable to credit quality, the loan s contractually required payments received in excess of the amount of its cash flows expected at acquisition, or nonaccretable discount, is not accreted into income. FASB ASC 310-30 requires that the Company recognize the excess of all cash flows expected at acquisition over the Company s initial investment in the loan as interest income using the interest method over the term of the loan. This excess is referred to as accretable discount and is recorded as a reduction of the loan balance.

Loans which, at acquisition, do not have evidence of deterioration of credit quality since origination are outside the scope of FASB ASC 310- 30. For such loans, the discount, if any, representing the excess of the amount of reasonably estimable and probable discounted future cash collections over the purchase price, is accreted into interest income using the interest method over the term of the loan. Prepayments are not considered in the calculation of accretion income. Additionally, the discount is not accreted on nonperforming loans.

When a loan is paid off, the excess of any cash received over the net investment is recorded as interest income. In addition to the amount of purchase discount that is recognized at that time, income may include interest owed by the borrower prior to the Company s acquisition of the loan, interest collected if on nonperforming status, prepayment fees and other loan fees.

NONPERFORMING ASSETS

In addition to nonperforming loans, nonperforming assets include other real estate owned. Other real estate owned is comprised of properties acquired through foreclosure or acceptance of a deed in lieu of foreclosure. Other real estate owned is recorded initially at the lower of cost or the estimated fair value less costs to sell. When such assets are acquired, the excess of the loan balance over the estimated fair value of the asset is charged to the allowance for loan losses. An allowance for losses on other real estate owned is established by a charge to earnings when, upon periodic evaluation by management, further declines in the estimated fair value of properties have occurred.

Such evaluations are based on an analysis of individual properties as well as a general assessment of current real estate market conditions. Holding costs and rental income on properties are included in current operations, while certain costs to improve such properties are capitalized. Gains and losses from the sale of other real estate owned are reflected in earnings when realized.

Table of Contents

Notes to Consolidated Financial Statements (Continued)

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is based on management s evaluation of the quality of the loan portfolio and is used to provide for losses resulting from loans that ultimately prove uncollectible. The components of the allowance for loan losses represent estimates based upon Accounting Standards Codification (ASC) Topic 450, contingencies, and ASC Topic 310 Receivables. ASC Topic 450 applies to homogenous loan pools such as consumer installment, residential mortgages, consumer lines of credit and commercial loans that are not individually evaluated for impairment under ASC Topic 310. In determining the level of the allowance, periodic evaluations are made of the loan portfolio, which takes into account factors such as the characteristics of the loans, loan status, financial strength of the borrowers, value of collateral securing the loans and other relevant information sufficient to reach an informed judgment. The allowance is increased by provisions charged to income and reduced by loan charge-offs, net of recoveries. Management maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance is based on assessments of the probable estimated losses inherent in the loan portfolio. Management s methodology for assessing the appropriateness of the allowance consists of several key elements, which include the specific allowances, if appropriate, for identified problem loans, formula allowance, and possibly an unallocated allowance. Arriving at an appropriate level of allowance for loan losses necessarily involves a high degree of judgment.

While management uses available information in establishing the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluations. Loans are charged-off in whole or in part when, in management s opinion, collectibility is not probable. The specific factors that management considers in making the determination that the collectibility of the loan s principal is not probable include the delinquency status of the loan, the fair value of the collateral and the financial strength of the borrower and/or guarantors.

Under ASC Topic 310, a loan is impaired, based upon current information and in management s opinion, when it is probable that the loan will not be repaid according to its original contractual terms, including both principal and interest, or if a loan is designated as a Troubled Debt Restructuring (TDR). Specific allowances for loan losses entail the assignment of allowance amounts to individual loans on the basis of loan impairment. Under this method, loans are selected for evaluation based upon a change in internal risk rating, occurrence of delinquency, loan classification or nonaccrual status. A specific allowance amount is allocated to an individual loan when such loan has been deemed impaired and when the amount of a probable loss is able to be estimated on the basis of: (a) present value of anticipated future cash flows, (b) the loan s observable fair market price or (c) fair value of collateral if the loan is collateral dependent. For collateral dependent loans, the amount of the recorded investment in a loan that exceeds the fair value of the collateral is charged-off against the allowance for loan losses in lieu of an allocation of a specific allowance when such an amount has been identified definitively as uncollectible.

In estimating probable loan loss under ASC Topic 450 management considers numerous factors, including historical charge-offs and subsequent recoveries. The formula allowances are based on evaluations of homogenous loans to determine the allocation appropriate within each portfolio segment. Formula allowances are based on internal risk ratings or credit ratings from external sources. Individual loans within the commercial and industrial, commercial real estate and real estate construction loan portfolio segments are assigned internal risk ratings to group them with other loans possessing similar risk characteristics. Changes in risk grades affect the amount of the formula allowance. Risk grades are determined by reviewing current collateral value, financial information, cash flow, payment history and other relevant facts surrounding the particular credit. On these loans, the formula allowances are based on the risk ratings, the historical loss experience, and the loss emergence period. Historical loss data and loss emergence periods are developed based on the Company s historical experience. For larger loans with available external credit ratings, these ratings are utilized rather than the Company s risk ratings. The historical loss factor and loss emergence periods for these loans are based on data published by the rating agencies for similar credits as the Company has limited internal historical data. For the residential real estate and consumer loan portfolios, the formula allowances are calculated by applying historical loss experience and the loss emergence period to the outstanding balance in each loan category. Loss factors and loss emergence periods are based on the Company s historical net loss experience.

Notes to Consolidated Financial Statements (Continued)

Additional allowances are added to portfolio segments based on qualitative factors. Management considers potential factors identified in regulatory guidance. Management has identified certain qualitative factors, which could impact the degree of loss sustained within the portfolio. These include market risk factors and unique portfolio risk factors that are inherent characteristics of the Company s loan portfolio. Market risk factors may consist of changes to general economic and business conditions, such as unemployment and GDP that may impact the Company s loan portfolio customer base in terms of ability to repay and that may result in changes in value of underlying collateral. Unique portfolio risk factors may include the outlooks for business segments in which the Company s borrowers operate and loan size. The potential ranges for qualitative factors are based on historical volatility in losses. The actual amount utilized is based on management s assessment of current conditions.

After considering the above components, an unallocated component may be generated to cover uncertainties that could affect management s estimate of probable losses. These uncertainties include the effects of loans in new geographical areas and new industries. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

BANK PREMISES AND EQUIPMENT

Bank premises and equipment are stated at cost less accumulated depreciation and amortization. Land is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets or the terms of leases, if shorter. It is general practice to charge the cost of maintenance and repairs to operations when incurred; major expenditures for improvements are capitalized and depreciated.

GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Goodwill is not subject to amortization. Identifiable intangible assets consist of core deposit intangibles and are assets resulting from acquisitions that are being amortized over their estimated useful lives. Goodwill and identifiable intangible assets are included in other assets on the consolidated balance sheets. The Company tests goodwill for impairment on an annual basis, or more often if events or circumstances indicate there may be impairment. Goodwill impairment testing is performed at the segment (or reporting unit) level. Currently, the Company s goodwill is evaluated at the entity level as there is only one reporting unit. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

Goodwill impairment is evaluated by first assessing qualitative factors (events and circumstances) to determine whether it is more likely than not (meaning a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. If, after considering all relevant events and circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test will be unnecessary.

The first step, in the two-step impairment test, used to identify potential impairment, involves comparing each reporting unit s fair value to its carrying value including goodwill. If the fair value of a reporting unit exceeds its carrying value, applicable goodwill is considered not to be impaired. If the carrying value exceeds fair value, there is an indication of impairment and the second step is performed to measure the amount of impairment.

SERVICING

The Company services mortgage loans for others. Mortgage servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. The valuation model incorporates assumptions that market participants would

Notes to Consolidated Financial Statements (Continued)

use in estimating future net servicing income, such as the cost to service, the discount rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into loan servicing fee income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant risk characteristics, such as interest rates and terms. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. Changes in the valuation allowance are reported in loan servicing fee income.

STOCK OPTION ACCOUNTING

The Company follows the fair value recognition provisions of FASB ASC 718, *Compensation Stock Compensation* for all share-based payments. The Company s method of valuation for share-based awards granted utilizes the Black-Scholes option-pricing model. The Company will recognize compensation expense for its awards on a straight-line basis over the requisite service period for the entire award (straight-line attribution method), ensuring that the amount of compensation cost recognized at any date at least equals the portion of the grant-date fair value of the award that is vested at that time.

During 2000 and 2004, common stockholders of the Company approved stock option plans (the Option Plans) that provide for granting of options to purchase up to 150,000 shares of Class A common stock per plan. Under the Option Plans, all officers and key employees of the Company are eligible to receive nonqualified or incentive stock options to purchase shares of Class A common stock. The Option Plans are administered by the Compensation Committee of the Board of Directors, whose members are ineligible to participate in the Option Plans. Based on management s recommendations, the Committee submits its recommendations to the Board of Directors as to persons to whom options are to be granted, the number of shares granted to each, the option price (which may not be less than 85% of the fair market value for nonqualified stock options, or the fair market value for incentive stock options, of the shares on the date of grant) and the time period over which the options are exercisable (not more than ten years from the date of grant). There were no options to purchase shares of Class A common stock outstanding at December 31, 2018.

The Company uses the fair value method to account for stock options. There were no options granted during 2018 and 2017.

INCOME TAXES

The Company uses the asset and liability method in accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. Under this method, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company accounts for uncertain tax positions in accordance with FASB ASC 740.

The Company classifies interest resulting from underpayment of income taxes as income tax expense in the first period the interest would begin accruing according to the provisions of the relevant tax law.

The Company classifies penalties resulting from underpayment of income taxes as income tax expense in the period for which the Company claims or expects to claim an uncertain tax position or in the period in which the Company s judgment changes regarding an uncertain tax position.

For tax years beginning after December 31, 2018, the corporate alternative minimum tax (AMT) has been repealed. For 2018 through 2021, the AMT credit carryforward can offset regular tax liability and is refundable in an amount equal to 50% (100% for 2021) of the excess of the minimum tax credit for the tax year over the

Notes to Consolidated Financial Statements (Continued)

amount of the credit allowable for the year against regular tax liability. Accordingly, the full amount of the AMT credit carryforward will be recovered in tax years beginning before 2022. As a result of the change, the Company has classified its AMT credit carryforward as currently receivable.

EARNINGS PER SHARE (EPS)

Class A and Class B shares participate equally in undistributed earnings. Under the Company s Articles of Organization, the holders of Class A Common Stock are entitled to receive dividends per share equal to at least 200% of dividends paid, if any, from time to time, on each share of Class B Common Stock.

Diluted EPS includes the dilutive effect of common stock equivalents; basic EPS excludes all common stock equivalents. The only common stock equivalents for the Company are stock options.

The company utilizes the two class method for reporting EPS. The two-class method is an earnings allocation formula that treats Class A and Class B shares as having rights to earnings that otherwise would have been available only to Class A shareholders and Class B shareholders as if converted to Class A shares.

TREASURY STOCK

Effective July 1, 2004, companies incorporated in Massachusetts became subject to Chapter 156D of the Massachusetts Business Corporation Act, provisions of which eliminate the concept of treasury stock and provide that shares reacquired by a company are to be treated as authorized but unissued shares.

PENSION

The Company provides pension benefits to its employees under a noncontributory, defined benefit plan, which is funded on a current basis in compliance with the requirements of the Employee Retirement Income Security Act of 1974 (ERISA) and recognizes costs over the estimated employee service period.

The Company also has a Supplemental Executive Insurance/Retirement Plan (the Supplemental Plan), which is limited to certain officers and employees of the Company. The Supplemental Plan is accrued on a current basis and recognizes costs over the estimated employee service period.

Executive officers of the Company or its subsidiaries who have at least one year of service may participate in the Supplemental Plan. The Supplemental Plan is voluntary. Individual life insurance policies, which are owned by the Company, are purchased covering the life of each participant.

The Company utilizes a full yield curve approach in the estimation of the service and interest components by applying the specific spot rates along the yield curve used in the determination of the benefit obligation to the underlying projected cash flows.

At December 31, 2018, the discount rate was determined by preparing an analysis of the respective plan s expected future cash flows and high-quality fixed-income investments currently available and expected to be available during the period to maturity of the benefits.

RECENT ACCOUNTING DEVELOPMENTS

Recently Adopted Accounting Standards Updates

Effective January 1, 2018, the following new accounting guidance was adopted by the Company:

In March 2018 Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-05: Income Taxes (Topic 740) Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 Income Tax Accounting Implications of the Tax Cuts and Jobs Act. This ASU is effective for fiscal years beginning after December 22, 2017. The effect of this update did not have a material impact on the Company s consolidated financial position.

In February 2018, the FASB issued ASU 2018-03, Technical Corrections and Improvements to Financial Instruments Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial

Notes to Consolidated Financial Statements (Continued)

Liabilities. The amendments in this Update include items brought to the Board s attention by stakeholders. The amendments clarify certain aspects of the guidance issued in Update 2016-1. For public entities, this ASU was effective for the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The effect of this update did not have a material impact on the Company s consolidated financial position.

In February 2018, the FASB issued ASU 2018-02, Income Statement Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendments in this ASU allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this ASU are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this ASU is permitted, including adoption in any interim period, (1) for public business entities for reporting periods for which financial statements have not yet been issued and (2) for all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this ASU should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company adopted this update in the first quarter of 2018 and applied the effects of the changes in the period of adoption. The effect of the changes is approximately $3.8 million that increased retained earnings and a corresponding decrease to AOCI.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting. FASB issued this Update to address the diversity in practice as well as the cost and complexity when applying the guidance in Topic 718, Compensation Stock Compensation, to a change to the terms or conditions of a share-based payment award. For public entities, this ASU was effective for annual reporting periods beginning after December 15, 2017. The effect of this update did not have a material impact on the Company s consolidated financial position.

In March 2017, the FASB issued ASU 2017-07, Compensation-Retirement Benefits (Topic 715) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The amendments in this ASU require that an employer disaggregate the service cost component from the other components of net benefit cost. The amendments also provide explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. The amendments in this ASU were effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. This ASU is for presentation purposes only, accordingly, there was no impact on the Company s consolidated financial position. See Note 17, Employee Benefits, for a further explanation of this ASU.

In February 2017, the FASB issued ASU 2017-05, Other Income Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20). This ASU was issued to clarify the scope of Subtopic 610-20, and to add guidance for partial sales of nonfinancial assets. For public entities, this ASU was effective for annual reporting periods beginning after December 15, 2017. The effect of this update did not have a material impact on the Company s consolidated financial position.

Effective January 1, 2018, the Company adopted ASU 2014-09 Revenue Recognition (Topic 606): Revenue from Contracts with Customers. ASU 2014-09 supersedes Topic 605 Revenue Recognition and requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services.

The vast majority of the Company s revenue is interest income on loans, investment securities and deposits at other financial institutions which are specifically outside the scope of ASU 2014-09. ASU 2014-09 applies

Notes to Consolidated Financial Statements (Continued)

primarily to certain non-interest income items in the Company s financial statements. We adopted Topic 606 as of January 1, 2018 using the cumulative effect transition method. The impact of adopting the new standard was not material. See Note 22, Revenue from Contracts with Customers, for further details.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230) *Restricted Cash.* The amendments of this ASU were issued to require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. For public entities, this ASU was effective for the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The effect of this update did not have a material impact on the Company s consolidated financial position.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 326) *Classification of Certain Cash Receipts and Cash Payments.* Stakeholders indicated that there is diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. This ASU addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments in this update were effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The effect of this update required a reclassification of $375,000 and $115,000 for 2018 and 2017, respectively, of proceeds from life insurance policies to investing activities from operating activities.

In January 2016, FASB issued ASU 2016-1, Financial Instruments-Overall (Subtopic 825-10) *Recognition and Measurement of Financial Assets and Financial Liabilities.* This ASU significantly revises an entity s accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. The Company used exit price notion when measuring the fair value of financial instruments for disclosure purposes (see Note 9 Fair Value of Financial Instruments). This ASU was effective for fiscal years beginning after December 15, 2017, including interim periods therein. The Company adopted this update in the first quarter of 2018 and applied the effects of the changes retrospectively. The effect of the changes is approximately $29,000, which was reclassified from accumulated other comprehensive income to retained earnings.

Accounting Standards Issued but not yet Adopted

The following list identifies ASUs applicable to the Company that have been issued by the FASB but are not yet effective:

In August 2018, FASB issued ASU 2018-15, Intangibles-Goodwill and Other-Internal Use Software (Subtopic 350-40): Customer s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force) The amendments in this ASU align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license).This ASU is effective for annual reporting periods beginning after December 15, 2019. The Company has not determined the impact, if any, as of December 31, 2018.

In August 2018, FASB issued ASU 2018-14, Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20): Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit plans. The amendments in this ASU remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. This ASU is effective for annual reporting periods beginning after December 15, 2020. The Company has not determined the impact, if any, as of December 31, 2018. In August 2018, FASB issued ASU 2018-13, Fair Value Measurement (Topic 820), Disclosure Framework-Changes to the Disclosure Requirements for Fair Value. The amendments in

Notes to Consolidated Financial Statements (Continued)

this ASU modify the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement, based on the concepts in the Concepts Statement, including the consideration of costs and benefits. This ASU is effective for annual reporting periods beginning after December 15, 2019. The Company has not determined the impact, if any, as of December 31, 2018.

In July 2017, FASB issued ASU 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815): I. Accounting for Certain Financial Instruments with Down Round Features II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interest with a Scope Exception. For public entities, this ASU is effective for annual reporting periods beginning after December 15, 2018. The effect of this update is not expected to have a material impact on the Company s consolidated financial position.

In March 2017, the FASB issued ASU 2017-08, Receivables Nonrefundable Fees and Other Costs (Subtopic 310-20) Premium Amortization of Purchased Callable Debt. The FASB is issuing this ASU to amend the amortization period for certain purchased callable debt securities held at a premium. The FASB is shortening the amortization period for the premium to the earliest call date. Under current generally accepted accounting principles (GAAP), entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. For public business entities, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The effect of this update is not expected to have a material impact on the Company s consolidated financial position.

In January 2017, the FASB issued ASU 2017-04, Intangibles Goodwill and Other (Topic 350). This ASU was issued to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. For public entities, this ASU is effective for the fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted and application should be on a prospective basis. The effect of this update is not expected to have a material impact on the Company s consolidated financial position.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU was issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is in the process of analyzing this ASU and has purchased a software solution and began to capture information needed to implement this update. The Company has started to input information and is in the beginning stages of running the software program. The Company has not determined the impact, if any, as of December 31, 2018.

In November 2018, the FASB issued ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments-Credit Losses. The amendments in this ASU align the implementation date for nonpublic entities annual financial statements with the implementation date for their interim financial statements and clarify the scope of the guidance in the amendments in ASU 2016-13. The Company has not determined the impact, if any, as of December 31, 2018.

In February 2016, the FASB issued ASU 2016-02, Leases. This ASU requires lessees to put most leases on their balance sheet but recognize expenses on their income statements in a manner similar to today s accounting. This ASU also eliminates today s real estate-specific provisions for all companies. For lessors, this ASU modifies the classification criteria and the accounting for sales-type and direct financing leases. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods therein. Early adoption is permitted. The Company began analyzing this ASU and assessed the implementation steps. At December 31, 2018, the Company analyzed the financial impact of real estate leases. The Company also reviewed contracts to

Table of Contents

Notes to Consolidated Financial Statements (Continued)

determine if they contain embedded leases. The Company has determined the total balance sheet impact will be approximately $14-$16 million as of December 31, 2018. This amount will be booked as a right of use asset with a corresponding lease liability.

In July 2018, ASU 2018-10, Codification Improvements to Topic 842, Leases (ASU 2018-10) was issued to provide more detailed guidance and additional clarification for implementing ASU 2016-02. Also in July 2018, ASU 2018-11, Targeted Improvements (ASU 2018-11) was issued and allows for an optional transition method in which the provisions of Topic 842 would be applied upon the adoption date and would not have to be retroactively applied to the earliest reporting period presented in the consolidated financial statements. The Company intends to use this optional transition method for the adoption of Topic 842.

Securities and Exchange Commission (SEC) ruling:

In August 2018, the SEC issued a final rule that amends certain of the Commission s disclosure requirements that have become redundant, duplicative, overlapping, outdated, or superseded, in light of other Commission disclosure requirements, U.S. GAAP, or changes in the information environment. The financial reporting implications of the final rule s amendments may vary by company, but the changes are generally expected to reduce or eliminate some of an SEC registrant s disclosure requirements. In limited circumstances, however, the amendments may expand those requirements, including those related to interim disclosures about changes in stockholders equity. Under the requirements, registrants must now analyze changes in stockholders equity, in the form of a reconciliation, for the current and comparative year-to-date periods, with subtotals for each interim period. The Company will therefore include a reconciliation for the current quarter and year-to-date interim periods as well as the comparative periods of the prior years (i.e., a reconciliation covering each period for which an income statement is presented). The final rule is effective for all filings submitted on or after November 5, 2018.

2. Cash and Due from Banks

The Company is required to maintain a portion of its cash and due from banks as a reserve balance under the Federal Reserve Act. Such reserve is calculated based upon deposit levels and amounted to $0 at December 31, 2018, and $0 at December 31, 2017.

3. Securities Available-for-Sale

	December 31, 2018				December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(dollars in thousands)								
U.S. Treasury	**$ 2,000**	**$**	**$ 8**	**$ 1,992**	$ 1,999	$	$ 15	$ 1,984
U. S. Government Sponsored Enterprises	**3,946**		**31**	**3,915**				

SBA Backed Securities	**70,477**	**1**	**284**	**70,194**	81,065	46	161	80,950
U.S. Government Agency and Sponsored Enterprises Mortgage-Backed Securities	**162,604**	**536**	**250**	**162,890**	225,537	555	317	225,775
Privately Issued Residential Mortgage-Backed Securities	**679**	**3**	**10**	**672**	897	4	9	892
Obligations Issued by States and Political Subdivisions	**93,445**	**58**		**93,503**	82,849		249	82,600
Other Debt Securities	**3,600**	**37**	**44**	**3,593**	3,600	68	39	3,629
Total	**$ 336,751**	**$ 635**	**$ 627**	**$ 336,759**	$ 395,947	$ 673	$ 790	$ 395,830

Notes to Consolidated Financial Statements (Continued)

Included in SBA Backed Securities and U.S. Government Agency and Sponsored Enterprises Mortgage-Backed Securities are securities at fair value pledged to secure public deposits and repurchase agreements amounting to $197,304,000 and $216,353,000 at December 31, 2018 and 2017, respectively. Also included in securities available-for-sale at fair value are securities pledged for borrowing at the Federal Home Loan Bank amounting to $34,787,000 and $67,780,000 at December 31, 2018 and 2017, respectively. The Company realized gains on sales of securities of $302,000, $47,000 and $52,000 from the proceeds of sales of available-for-sale securities of $27,517,000, $18,180,000 and $2,376,000 for the years ended December 31, 2018, 2017, and 2016, respectively.

Debt securities of U.S. Government Agency and Sponsored Enterprises Mortgage-Backed Securities primarily refer to debt securities of Fannie Mae and Freddie Mac.

The following table shows the estimated maturity distribution of the Company s securities available-for-sale at December 31, 2018.

(dollars in thousands)	Amortized Cost	Fair Value
Within one year	**$ 92,935**	**$ 92,918**
After one but within five years	**83,286**	**83,112**
After five but within ten years	**136,075**	**136,244**
More than ten years	**24,455**	**24,485**
Total	**$ 336,751**	**$ 336,759**

The weighted average remaining life of investment securities available-for-sale at December 31, 2018, was 4.7 years. Included in the weighted average remaining life calculation at December 31, 2018 were $3,946,000 of U.S. Government Sponsored Enterprises obligations that are callable at the discretion of the issuer. The contractual maturities, which were used in the table above, of mortgage-backed securities, will differ from the actual maturities due to the ability of the issuers to prepay underlying obligations. Also, $231,981,000 of the securities are floating rate or adjustable rate and reprice prior to maturity.

As of December 31, 2018 and December 31, 2017, management concluded that the unrealized losses of its investment securities are temporary in nature since they are not related to the underlying credit quality of the issuers, and the Company does not intend to sell these debt securities and it is not more likely than not that it will be required to sell these debt securities before the anticipated recovery of its remaining amortized cost. In making its other-than-temporary impairment evaluation, the Company considered the fact that the principal and interest on these securities are from issuers that are investment grade. The change in the unrealized losses on the Obligations Issued by States and Political Subdivisions, Privately Issued Residential Mortgage-Backed Securities and Other Debt Securities was primarily caused by changes in credit spreads and liquidity issues in the marketplace.

The unrealized loss on SBA Backed Securities and U.S. Government Agency and Sponsored Enterprises Mortgage-Backed Securities related primarily to interest rates and not credit quality and because the Company has the ability and intent to hold these investments until recovery of fair value, which may be maturity. The Company does not consider these investments to be other-than-temporarily impaired at December 31, 2018 and December 31, 2017.

In evaluating the underlying credit quality of a security, management considers several factors such as the credit rating of the obligor and the issuer, if applicable. Internal reviews of issuer financial statements are performed as deemed necessary. In the case of privately issued mortgage-backed securities, the performance of the underlying loans is analyzed as deemed necessary to determine the estimated future cash flows of the securities. Factors considered include the level of subordination, current and estimated future default rates,

Table of Contents

Notes to Consolidated Financial Statements (Continued)

current and estimated prepayment rates, estimated loss severity rates, geographic concentrations and origination dates of underlying loans.

The following table shows the temporarily impaired securities of the Company s available-for-sale portfolio at December 31, 2018. This table shows the unrealized market loss of securities that have been in a continuous unrealized loss position for 12 months or less and a continuous loss position for 12 months and longer. There are 10 and 30 securities that are temporarily impaired for less than 12 months and for 12 months or longer, respectively, out of a total of 190 holdings at December 31, 2018.

	December 31, 2018					
	Less Than 12 Months		12 Months or Longer		Total	
Temporarily Impaired Investments (dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury	$	$	$ 1,992	$ 8	$ 1,992	$ 8
U.S. Government Sponsored Enterprises	3,914	31			3,914	31
SBA Backed Securities	17,950	28	44,323	256	62,273	284
U.S. Government Agency and Sponsored Enterprise Mortgage-Backed Securities	19,244	21	45,782	229	65,026	250
Privately Issued Residential Mortgage-Backed Securities			495	10	495	10
Obligations Issued by States and Political Subdivisions						
Other Debt Securities			455	44	455	44
Total temporarily impaired securities	$ 41,108	$ 80	$ 93,047	$ 547	$ 134,155	$ 627

57

Table of Contents

Notes to Consolidated Financial Statements (Continued)

The following table shows the temporarily impaired securities of the Company s available-for-sale portfolio at December 31, 2017. This table shows the unrealized market loss of securities that have been in a continuous unrealized loss position for 12 months or less and a continuous loss position for 12 months and longer. There are 16 and 26 securities that are temporarily impaired for less than 12 months and for 12 months or longer, respectively, out of a total of 249 holdings at December 31, 2017.

	December 31, 2017					
	Less Than 12 Months		12 Months or Longer		Total	
Temporarily Impaired Investments (dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury	$ 1,984	$ 15	$	$	$ 1,984	$ 15
U.S. Government Sponsored Enterprises						
SBA Backed Securities	18,378	54	40,911	107	59,289	161
U.S. Government Agency and Sponsored Enterprise Mortgage-Backed Securities	40,394	123	59,336	194	99,730	317
Privately Issued Residential Mortgage-Backed Securities			633	9	633	9
Obligations Issued by States and Political Subdivisions			4,458	249	4,458	249
Other Debt Securities	400	1	461	38	861	39
Total temporarily impaired securities	$ 61,156	$ 193	$ 105,799	$ 597	$ 166,955	$ 790

4. Investment Securities Held-to-Maturity

	December 31, 2018				December 31, 2017			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury	**$ 9,960**	**$**	**$ 2**	**$ 9,958**	$	$	$	$
U.S. Government Sponsored Enterprises	**234,228**	**336**	**803**	**233,761**	104,653	341	472	104,522

SBA Backed Securities	**52,051**		**2,065**	**49,986**	57,235	20	1,271	55,984
U.S. Government Sponsored Enterprises Mortgage-Backed Securities	**1,750,408**	**2,324**	**55,016**	**1,697,716**	1,539,345	2,261	33,285	1,508,321
Total	**$ 2,046,647**	**$ 2,660**	**$ 57,886**	**$ 1,991,421**	$ 1,701,233	$ 2,622	$ 35,028	$ 1,668,827

Included in U.S. Government Sponsored Enterprises and U.S. Government Sponsored Enterprise Mortgage-Backed Securities are securities pledged to secure public deposits and repurchase agreements at fair value amounting to $1,441,059,000 and $1,262,708,000 at December 31, 2018, and 2017, respectively. Also included are securities pledged for borrowing at the Federal Home Loan Bank at fair value amounting to $291,190,000

Notes to Consolidated Financial Statements (Continued)

and $382,120,000 at December 31, 2018, and 2017, respectively. The Company did not realize any gains of sales of securities for the year ending December 31, 2018, and 2017. The sales from securities held-to-maturity relate to certain mortgage-backed securities for which the Company had previously collected a substantial portion of its principal investment. The Company realized gains on sales of securities of $12,000 from the proceeds of sales of held-to-maturity securities of $192,000 for the year ending December 31, 2016.

At December 31, 2018 and 2017, all mortgage-backed securities are obligations of U.S. Government Sponsored Enterprises. Government Sponsored Enterprises primarily refer to debt securities of Fannie Mae and Freddie Mac.

The following table shows the maturity distribution of the Company s securities held-to-maturity at December 31, 2018.

(dollars in thousands)	Amortized Cost	Fair Value
Within one year	**$ 41,154**	**$ 41,013**
After one but within five years	**1,490,954**	**1,454,543**
After five but within ten years	**506,654**	**488,129**
More than ten years	**7,885**	**7,736**
Total	**$ 2,046,647**	**$ 1,991,421**

The weighted average remaining life of investment securities held-to-maturity at December 31, 2018, was 4.3 years. Included in the weighted average remaining life calculation at December 31, 2018, were $149,156,000 of U.S. Government Sponsored Enterprises obligations that are callable at the discretion of the issuer. The contractual maturities, which were used in the table above, of mortgage-backed securities, will differ from the actual maturities due to the ability of the issuers to prepay underlying obligations. Also, $124,000 of the securities are floating rate or adjustable rate and reprice prior to maturity.

As of December 31, 2018 and December 31, 2017, management concluded that the unrealized losses of its investment securities are temporary in nature since they are not related to the underlying credit quality of the issuers, and the Company does not intend to sell these debt securities and it is not more likely than not that it will be required to sell these debt securities before the anticipated recovery of their remaining amortized costs. In making its other-than-temporary impairment evaluation, the Company considered the fact that the principal and interest on these securities are from issuers that are investment grade.

The unrealized loss on U.S. Government Sponsored Enterprises, SBA Backed Securities and U.S. Government Sponsored Enterprises Mortgage-Backed Securities related primarily to interest rates and not credit quality, and because the Company does not intend to sell any of these securities and it is not more likely than not that it will be required to sell these securities before the anticipated recovery of the remaining amortized cost, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2018 and December 31, 2017.

In evaluating the underlying credit quality of a security, management considers several factors such as the credit rating of the obligor and the issuer, if applicable. Internal reviews of issuer financial statements are performed as deemed necessary.

Table of Contents

Notes to Consolidated Financial Statements (Continued)

The following table shows the temporarily impaired securities of the Company s held-to-maturity portfolio at December 31, 2018. This table shows the unrealized market loss of securities that have been in a continuous unrealized loss position for 12 months or less and a continuous loss position for 12 months and longer. There are 56 and 315 securities that are temporarily impaired for less than 12 months and for 12 months or longer, respectively, out of a total of 475 holdings at December 31, 2018.

	December 31, 2018					
	Less Than 12 Months		12 Months or Longer		Total	
Temporarily Impaired Investments (dollars in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury	**$ 9,958**	&n				