FIRST COMMUNITY BANCSHARES INC /NV/
Form 10-K
March 05, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended **December 31, 2017**

Commission file number **000-19297**

FIRST COMMUNITY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Nevada	**55-0694814**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

P.O. Box 989

Bluefield, Virginia 24605-0989

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(276) 326-9000**

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

Title of each class	Name of each exchange on which registered
Common Stock, $1.00 par value	**NASDAQ Global Select**

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	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

As of June 30, 2017, the aggregate market value of the registrant's voting and non-voting common stock held by non-affiliates was $351.27 million.

As of February 28, 2018, there were 16,945,756 shares outstanding of the registrant's Common Stock, $1.00 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on April 24, 2018, are incorporated by reference in Part III of this Form 10-K.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Forward-looking statements in filings with the Securities and Exchange Commission, including this Annual Report on Form 10-K and the accompanying Exhibits, filings incorporated by reference, reports to shareholders, and other communications that represent the Company's beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates, and intentions are made in good faith pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. The words "may," "could," "should," "would," "believe," "anticipat "estimate," "expect," "intend," "plan," and other similar expressions identify forward-looking statements. The following factors, among others, could cause financial performance to differ materially from that expressed in such forward-looking statements:

- the strength of the U.S. economy in general and the strength of the local economies in which we conduct operations;
- the effects of, and changes in, trade, monetary, and fiscal policies and laws, including interest rate policies of the Federal Reserve System;
- inflation, interest rate, market and monetary fluctuations;
- timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
- the willingness of customers to substitute competitors' products and services for the Company's products and services and vice versa;
- the impact of changes in financial services laws and regulations, including laws about taxes, banking, securities, and insurance, and the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- the impact of the U.S. Department of the Treasury and federal banking regulators' continued implementation of programs to address capital and liquidity in the banking system;
- further, future, and proposed rules, including those that are part of the process outlined in the Basel Committee on Banking Supervision's "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems," which require banking institutions to increase levels of capital;
- technological changes;
- the effect of acquisitions, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;
- the growth and profitability of noninterest, or fee, income being less than expected;
- unanticipated regulatory or judicial proceedings;
- changes in consumer spending and saving habits; and
- the Company's success at managing the risks mentioned above.

The list of important factors is not exclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking statements contained in this Annual Report on Form 10-K and other reports we file with the Securities and Exchange Commission. Therefore, the Company cautions you not to place undue reliance on forward-looking information and statements. The Company does not intend to update any forward-looking statements, whether written or oral, to reflect changes. These cautionary statements expressly qualify all forward-looking statements that apply to the Company including the risk factors presented in Part I, Item 1A of this report.

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PART I

Item 1. Business.

General

First Community Bancshares, Inc. (the “Company”), a financial holding company, was founded in 1989 and incorporated under the laws of Nevada in 1997. The Company’s principal executive office is located at One Community Place, Bluefield, Virginia. The Company provides commercial banking products and services through its wholly owned subsidiary First Community Bank (the “Bank”), a Virginia-chartered banking institution founded in 1874. The Bank operates as First Community Bank in Virginia, West Virginia, and North Carolina and People’s Community Bank, a Division of First Community Bank, in Tennessee. The Bank provides insurance services through its wholly owned subsidiary First Community Insurance Services and offers wealth management and investment advice through its Trust Division and wholly owned subsidiary First Community Wealth Management. Unless the context suggests otherwise, the terms “First Community,” “Company,” “we,” “our,” and “us” in this Annual Report on Form 10-K refer to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity.

We focus on building financial partnerships and creating enduring and complete relationships with businesses and individuals through a personal and local approach to banking and financial services. We strive to be the bank of choice in the markets we serve by offering impeccable service and a complete line of competitive products that include:

- demand deposit accounts, savings and money market accounts, certificates of deposit, and individual retirement arrangements;
- commercial, consumer, and real estate mortgage loans and lines of credit;
- various credit card, debit card, and automated teller machine card services;
- corporate and personal trust services;
- investment management services; and
- life, health, and property and casualty insurance products.

Our operations are guided by a strategic plan that focuses on organic growth supplemented by strategic acquisitions of complementary financial institutions. For a summary of our financial performance, see Item 6, “Selected Financial Data,” in Part II of this report.

Employees

As of December 31, 2017, we had 562 full-time equivalent employees. Our employees are not represented by collective bargaining agreements and we consider employee relations to be excellent.

Market Area

As of December 31, 2017, we operated 44 branch locations in Virginia, West Virginia, North Carolina, and Tennessee through our sole operating segment, Community Banking. Economic indicators in our market areas show relatively stable employment and business conditions. We serve a diverse base of individuals and businesses across a variety of industries such as education, government, and health services; coal mining and gas extraction; retail trade; construction; manufacturing; tourism; and transportation.

Competition

The financial services industry is highly competitive and constantly evolving. We encounter strong competition in attracting and retaining deposit, loan, and other financial relationships in our market areas. We compete with other commercial banks, thrifts, savings and loan associations, credit unions, consumer finance companies, mortgage banking firms, commercial finance and leasing companies, securities firms, brokerage firms, and insurance companies. We have positioned ourselves as a regional community bank that provides an alternative to larger banks, which often place less emphasis on personal relationships, and smaller community banks, which lack the capital and resources to efficiently serve customer needs. Factors that influence our ability to remain competitive include the ability to develop, maintain, and build long-term customer relationships; the quality, variety, and pricing of products and services; the convenience of banking locations and office hours; technological developments; and industry and general economic conditions. We seek to mitigate these pressures with our relationship style of banking, competitive pricing, cost efficiencies, and disciplined approach to loan underwriting.

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Supervision and Regulation

Overview

We are subject to extensive examination, supervision, and regulation under applicable federal and state laws and various regulatory agencies. These regulations are intended to protect consumers, depositors, borrowers, deposit insurance funds, and the stability of the financial system and are not for the protection of stockholders or creditors.

Applicable laws and regulations restrict our permissible activities and investments and impose conditions and requirements on the products and services we offer and the manner in which they are offered and sold. They also restrict our ability to repurchase stock or pay dividends, or to receive dividends from our banking subsidiary, and impose capital adequacy requirements on the Company and the Bank. The consequences of noncompliance with these laws and regulations can include substantial monetary and nonmonetary sanctions.

The following discussion summarizes significant laws and regulations applicable to the Company and the Bank. These summaries are not intended to be complete and are qualified in their entirety by reference to the applicable statute or regulation. Changes in laws and regulations may have a material effect on our business, financial condition, or results of operations.

First Community Bancshares, Inc.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, (“BHC Act”) and a financial holding company under the Gramm-Leach-Bliley Act of 1999 (“GLB Act”). The Company elected financial holding company status in December 2006. The Company and its subsidiaries are subject to supervision, regulation, and examination by the Board of Governors of the Federal Reserve System (“Federal Reserve”). The BHC Act generally provides for umbrella regulation of financial holding companies, such as the Company, by the Federal Reserve, as well as functional regulation of financial holding company subsidiaries by applicable regulatory agencies. The Federal Reserve is granted the authority, in certain circumstances, to require reports of, examine, and adopt rules applicable to any bank holding company subsidiary.

The Company is also subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, (“Exchange Act”), as administered by the Securities and Exchange Commission (“SEC”). The Company’s common stock is listed on the NASDAQ Global Select Market under the trading symbol FCBC and is subject to NASDAQ’s rules for listed companies.

First Community Bank

The Bank is a Virginia state-chartered bank and a member of the Federal Reserve subject to supervision, regulation, and examination by the Virginia Bureau of Financial Institutions and the Federal Reserve Bank ("FRB") of Richmond. The Bank is a member of the Federal Deposit Insurance Corporation ("FDIC"), and its deposits are insured by the FDIC to the extent provided by law. The regulations of these agencies govern most aspects of the Bank's business, including requirements concerning the allowance for loan losses, lending and mortgage operations, interest rates received on loans and paid on deposits, the payment of dividends, loans to affiliates, mergers and acquisitions, capital, and the establishment of branches. Various consumer and compliance laws and regulations also affect the Bank's operations.

As a member bank, the Bank is required to hold stock in the FRB of Richmond in an amount equal to 6% of their capital stock and surplus (half paid to acquire the stock with the remainder held as a cash reserve). Member banks do not have any control over the Federal Reserve as a result of owning the stock and the stock cannot be sold or traded.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") of 2010 significantly restructured the U.S. financial regulatory regime. The Dodd-Frank Act is extensive, complicated, and comprehensive legislation that impacts practically all aspects of a banking organization, including the following provisions:

- centralizes responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau ("CFPB"), responsible for implementing, examining and enforcing compliance with federal consumer financial laws;
- requires financial holding companies, such as the Company, to be well-capitalized and well managed (bank holding companies and banks must also be well-capitalized and well managed to engage in interstate bank acquisitions);

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- imposes comprehensive regulation of the over-the-counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institutions themselves;
- implements corporate governance revisions, including executive compensation and proxy access by shareholders;
- makes permanent the $250 thousand limit for federal deposit insurance;
- repeals the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;
- amends the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules about interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and enforces a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer; and
- increases the authority of the Federal Reserve to examine bank holding companies, such as the Company, and their non-bank subsidiaries.

Many of the provisions of the Dodd-Frank Act and other laws are subject to further rulemaking, guidance, and interpretation by applicable federal regulators. We continue to evaluate the impact of any new regulations.

Permitted Activities under the BHC Act

The BHC Act limits the activities of bank holding companies, such as the Company, to the business of banking, managing or controlling banks and other activities the Federal Reserve determines to be closely related to banking. A bank holding company that elects treatment as a financial holding company under the GLB Act, such as the Company, may engage in a broader range of activities that are financial in nature or complementary to a financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system. These activities include securities underwriting, dealing, and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and other activities that the Federal Reserve determines to be closely related to banking.

In order to maintain financial holding company status, the Company and the Bank must be well-capitalized and well-managed under applicable Federal Reserve regulations and have received at least a satisfactory rating under the Community Reinvestment Act (“CRA”). See “Prompt Corrective Action” and “Community Reinvestment Act” below. If we fail to meet these requirements, the Federal Reserve may impose corrective capital and managerial requirements and place limitations or conditions on our ability to conduct activities permissible for financial holding companies. If the deficiencies persist, the Federal Reserve may require the Company to divest the Bank or divest investments in companies engaged in activities permissible only for financial holding companies.

The Company is required to give the Federal Reserve prior notice of any redemption or repurchase of its own equity securities, subject to certain exemptions, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding 12 months, is equal to 10% or more of the Company’s consolidated net worth. The Federal Reserve may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation.

The BHC Act requires that bank holding companies obtain the Federal Reserve's approval before acquiring direct or indirect ownership or control of more than 5% of the voting shares or all, or substantially all, of the assets of a bank. The regulatory authorities are required to consider the financial and managerial resources and future prospects of the bank holding company and the target bank, the convenience and needs of the communities to be served, and various competitive factors when approving acquisitions. The BHC Act also prohibits a bank holding company from acquiring direct or indirect control of more than 5% of the outstanding voting stock of any company engaged in a non-banking business unless the Federal Reserve determines it to be closely related to banking.

Capital Requirements

We are subject to various regulatory capital requirements administered by the Federal Reserve. The current risk-based capital requirements applicable to the Company and the Bank, parts of which are currently in the process of being phased in, are based on the December 2010 international capital standards of the Basel Committee on Banking Supervision ("Basel Committee"), known as Basel III.

Prior to January 1, 2015, the risk-based capital requirements that applied to the Company and the Bank were based on the 1988 capital accord of the Basel Committee, known as Basel I. Under Basel I, the Company was required to maintain a minimum Tier 1 capital ratio of 4.0%, a total capital ratio of 8.0%, and Tier 1 capital to average consolidated assets ("Tier 1 leverage ratio") of 3.0%. Certain highly rated bank holding companies could maintain a minimum Tier 1 leverage ratio of 3.0%, but other bank holding companies were required to maintain a Tier 1 leverage ratio of 4.0% or more, depending on their condition.

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On July 2, 2013, the Federal Reserve approved capital rules for U.S. banking organizations implementing Basel III ("Basel III Capital Rules") and certain requirements of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules. Basel III Capital Rules (1) introduced a new Common Equity Tier 1 ("CET1") capital measure, (2) specified that Tier 1 capital consist of CET1 and additional Tier 1 capital instruments meeting specified requirements, (3) defined CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and (4) expanded the scope of the deductions/adjustments to capital as compared to prior regulations. The following initial minimum capital ratios became effective, subject to a phase-in period, for the Company and the Bank under Basel III Capital Rules on January 1, 2015:

- 4.5% CET1 to risk-weighted assets
- 6.0% Tier 1 capital (CET1 plus additional Tier 1 capital) to risk-weighted assets
- 8.0% Total capital (Tier 1 plus Tier 2 capital) to risk-weighted assets
- 4.0% Tier 1 leverage ratio

Basel III Capital Rules introduced a capital conservation buffer designed to absorb losses during periods of economic stress. The capital conservation buffer was implemented on January 1, 2016, at 0.625% and will be phased in over a four-year period (increasing by an additional 0.625% each year until it reaches 2.5% on January 1, 2019). Basel III Capital Rules also provide for a countercyclical capital buffer that applies to certain covered institutions; however, the buffer does not apply to the Company or the Bank. Banking institutions with a CET1 to risk-weighted assets ratio above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, if applicable) face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

When fully phased in on January 1, 2019, Basel III Capital Rules will require the Company and the Bank to maintain an additional capital conservation buffer of 2.5% of CET1, effectively resulting in the following minimum ratios:

- 7.0% CET1 to risk-weighted assets
- 8.5% Tier 1 capital to risk-weighted assets
- 10.5% Total capital to risk-weighted assets
- 4.0% Tier 1 leverage ratio

Management believes that the Company and the Bank would meet all capital adequacy requirements under Basel III Capital Rules on a fully phased-in basis, if such requirements were in effect, as of December 31, 2017.

Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that certain deferred tax assets and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories, in the aggregate, exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015, at 40% and will be phased in over a four-year period (increasing an additional 20% each year until it reaches 100% on January 1, 2018).

Basel III Capital Rules prevent certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies, subject to phase-out. The rules do not require a phase-out of trust preferred securities issued before May 19, 2010, for holding companies of depository institutions with less than $15 billion in consolidated total assets, as of December 1, 2009.

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

Prompt Corrective Action

The federal banking regulators are required to take prompt corrective action with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if the appropriate federal regulators determine that it is engaging in an unsafe or unsound practice or is in an unsafe or unsound condition. A bank’s capital category is determined solely for applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank’s financial condition or prospects for other purposes.

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The Bank was classified as well-capitalized under prompt corrective action regulation as of December 31, 2017. In order to be considered a well-capitalized institution under Basel III Capital Rules, an organization must not be subject to any written agreement, order, capital directive, or prompt corrective action directive and must maintain the following minimum capital ratios:

- 6.5% CET1 to risk-weighted assets
- 8.0% Tier 1 capital to risk-weighted assets
- 10.0% Total capital to risk-weighted assets
- 5.0% Tier 1 leverage ratio

Undercapitalized institutions are required to submit a capital restoration plan to federal banking regulators. Under the Federal Deposit Insurance Act, as amended ("FDIA"), in order for the capital restoration plan to be accepted by the appropriate federal banking agency, a bank holding company must provide appropriate assurances of performance and guarantee that its subsidiary bank will comply with its capital restoration plan, subject to certain limitations. Agency regulations contain broad restrictions on certain activities of undercapitalized institutions, including asset growth, acquisitions, establishing branches, and engaging in new lines of business. With certain exceptions, a depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to its parent holding company if the institution would be undercapitalized after such distribution or payment.

A significantly undercapitalized institution is subject to various requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, and ending deposits from correspondent banks. The FDIC has limited discretion in dealing with a critically undercapitalized institution and is generally required to appoint a receiver or conservator.

Safety and Soundness Standards

Guidelines adopted by federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage risks and exposures. If an institution fails to meet safety and soundness standards, the regulatory agencies may require the institution to submit a written compliance plan describing the steps they would take to correct the situation and the time that such steps would be taken. If an institution fails to submit or implement an acceptable compliance plan, after being notified, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions, such as those applicable to undercapitalized institutions under the prompt corrective action provisions of the FDIA. An institution may be subject to judicial proceedings and civil money penalties if it fails to follow such an order.

Payment of Dividends

The Company is a legal entity that is separate and distinct from its subsidiaries. The Company's principal source of cash flow is derived from dividends paid by the Bank. There are various restrictions by regulatory agencies related to dividends paid by the Bank to the Company and dividends paid by the Company to its shareholders. The payment of dividends by the Company and the Bank may be limited by certain factors, such as requirements to maintain capital above regulatory guideline minimums.

Prior FRB approval is required for the Bank to declare or pay a dividend to the Company if the total of all dividends declared in any given year exceed the total of the Bank's net profits for that year and its retained profits for the preceding two years, less any required transfers to surplus or to fund the retirement of preferred stock. Dividends paid by the Company to shareholders are subject to oversight by the Federal Reserve. Federal Reserve policy states that bank holding companies generally should pay dividends on common stock only from income available over the past year if prospective earnings retention is consistent with the organization's expected future needs, asset quality, and financial condition.

Regulatory agencies have the authority to limit or prohibit the Company and the Bank from paying dividends if the payments are deemed to constitute an unsafe or unsound practice. The appropriate regulatory authorities have stated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only from current operating earnings. In addition, the Bank may not declare or pay a dividend if, after paying the dividend, the Bank would be classified as undercapitalized. In the current financial and economic environment, the FRB has discouraged payout ratios that are at maximum allowable levels, unless both asset quality and capital are very strong, and has noted that bank holding companies should carefully review their dividend policy. Bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to their banking subsidiaries.

Source of Strength

Federal Reserve policy and federal law requires the Company to act as a source of financial and managerial strength to the Bank. Under this requirement, the Company is expected to commit resources to support the Bank even when it may not be in a financial position to provide such resources. Because the Company is a legal entity separate and distinct from its subsidiaries, any capital loans it makes to the Bank are subordinate in right of payment to depositors and to certain other indebtedness of the Bank. In the event of the Company's bankruptcy, any commitment by the Company to a federal bank regulatory agency to maintain the capital of the Bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Transactions with Affiliates

The Federal Reserve Act ("FRA") and Federal Reserve Regulation W place restrictions on "covered transactions" between the Bank and its affiliates, including the Company. The term "covered transactions" includes making loans, purchasing assets, issuing guarantees, and other similar transactions. The Dodd-Frank Act expanded the definition of "covered transactions" to include derivative activities, repurchase agreements, and securities lending or borrowing activities. These restrictions limit the amount of transactions with affiliates, require certain levels of collateral for loans to affiliates, and require that all transactions with affiliates be on terms that are consistent with safe and sound banking practices. In addition, these transactions must be on terms that are substantially the same, or at least as favorable to the Bank, as those prevailing at the time for similar transactions with non-affiliates.

The FRA and Federal Reserve Regulation O place restrictions on loans between the Company and the Bank and their directors, executive officers, principal shareholders, affiliates, and interests of those directors, executive officers, and principal shareholders. These restrictions limit the amount of loans to one borrower and require that loans are on terms that are substantially the same as, and follow underwriting procedures that are not less stringent than, those prevailing at the time for similar loans with non-insiders. In addition, the aggregate limit of loans to all insiders, as a group, cannot exceed the Bank's total unimpaired capital and surplus.

Deposit Insurance and Assessments

Substantially all of the Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC and are subject to quarterly deposit insurance assessments to maintain the DIF. FDIC deposit insurance premiums are assessed using a risk-based system that places FDIC-insured institutions into one of four risk categories based on capital, supervisory ratings and other factors. The assessment rate determined by considering such information is then applied to the institution's average assets minus average tangible equity to determine the institution's insurance premium. The FDIC may change assessment rates or revise its risk-based assessment system if deemed necessary to maintain an adequate reserve ratio for the DIF. The Dodd-Frank Act required that the minimum reserve ratio for the DIF increase from 1.15% to 1.35% by September 30, 2020. Under the FDIA, the FDIC may terminate deposit insurance if it determines that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC. The Bank's FDIC deposit insurance assessments totaled $797 thousand in 2017, $1.25 million in 2016, and $1.42 million in 2015.

In addition, all FDIC-insured institutions must pay annual assessments to fund interest payments on bonds issued by the Financing Corporation ("FICO"). The FICO is a mixed-ownership government corporation that was formed to borrow the money necessary to carry out the closing and ultimate disposition of failed thrift institutions by the Resolution Trust Corporation. The Bank's FICO assessments, which are set quarterly, totaled $113 thousand in 2017, $124 thousand in 2016, and $139 thousand in 2015.

The Volcker Rule

The Dodd-Frank Act amended the BHC Act to prohibit depository institutions and their affiliates from engaging in proprietary trading and from investing in, sponsoring, or having certain relationships with hedge funds or private equity funds, known as the Volcker Rule. These prohibitions are subject to a number of statutory exemptions, restrictions, and definitions. The Volcker Rule became effective on April 1, 2014, but the Federal Reserve extended the conformance period for certain requirements to July 21, 2017. Upon application of a banking entity, the Federal Reserve may provide an additional transition period of up to 5 years to conform investments in a limited class of legacy illiquid funds. The Volcker Rule has not had a material effect on the operations of the Company and subsidiaries, as the Company does not engage in the businesses prohibited by the Volcker Rule. The Company may incur costs to adopt additional policies and systems to ensure compliance with the Volcker Rule, but any such costs are not expected to be material.

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Community Reinvestment Act

The CRA of 1977, as amended, requires depository institutions to help meet the credit needs of their market areas, including low- and moderate-income individuals and communities, consistent with safe and sound banking practices. Federal banking regulators periodically examine depository institutions and assign ratings based on CRA compliance. A rating of less than satisfactory may restrict certain operating activities, delay or deny certain transactions, or result in an institution losing its financial holding company status. The Bank received a rating of satisfactory in its most recent CRA examination.

Incentive Compensation

Federal regulatory agencies have issued comprehensive guidance intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance is based on the key principles that a banking organization's incentive compensation arrangements should (1) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (2) be compatible with effective internal controls and risk management, and (3) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

Federal banking regulators periodically examine the incentive compensation arrangements of banking organizations and incorporate any deficiencies in the organization's supervisory ratings, which can affect certain operating activities. The FRB may initiate enforcement actions if the organization's incentive compensation arrangements or related risk management, control, or governance processes pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies. The scope and content of the U.S. banking regulators' policies on incentive compensation are continuing to develop. It cannot be determined at this time if or when a final rule will be adopted or if compliance with such a final rule will adversely affect the ability of the Company and its subsidiaries to hire, retain and motivate their key employees.

Anti-Tying Restrictions

The Bank and its affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by the Company.

Consumer Protection and Privacy

We are subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. These laws and regulations include the Mortgage Reform and Anti-Predatory Lending Act, the Truth in Lending Act, the Truth in Savings Act, the Home Mortgage Disclosure Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Right to Financial Privacy Act, the Fair Housing Act, and various state law counterparts. These laws and regulations contain extensive customer privacy protection provisions that limit the ability of financial institutions to disclose non-public information about consumers to non-affiliated third parties and require financial institutions to disclose certain policies to consumers.

The CFPB is a federal agency with broad authority to implement, examine, and enforce compliance with federal consumer protection laws that relate to credit card, deposit, mortgage, and other consumer financial products and services. The CFPB may enforce actions to prevent and remedy unfair, deceptive, or abusive acts and practices related to consumer financial products and services. The agency has authority to impose new disclosure requirements for any consumer financial product or service. The CFPB may impose a civil penalty or injunction against an entity in violation of federal consumer financial laws.

Cybersecurity

In March 2015, federal regulators issued two related statements about cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution’s management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption, and maintenance of the institution’s operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If the Bank fails to observe the regulatory guidance, the Bank could be subject to various regulatory sanctions, including financial penalties.

Bank Secrecy Act and Anti-Money Laundering

The Bank is subject to the requirements of the Bank Secrecy Act and the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (“USA PATRIOT Act”) of 2001. The USA PATRIOT Act broadened existing anti-money laundering legislation by imposing new compliance and due diligence obligations focused on detecting and reporting money laundering transactions. These laws and regulations require the Bank to implement policies, procedures, and controls to detect, prevent, and report money laundering and terrorist financing and to verify the identity of our customers. Violations can result in substantial civil and criminal sanctions. In addition, provisions of the USA PATRIOT Act require the federal financial regulatory agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing mergers and acquisitions.

Office of Foreign Assets Control Regulation

The U.S. Department of the Treasury’s (“Treasury”) Office of Foreign Assets Control (“OFAC”) administers and enforces economic and trade sanctions against targeted foreign countries and regimes, under authority of various laws, including designated foreign countries, nationals, and others. OFAC publishes lists of specially designated targets and countries. We are responsible for, among other things, blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them, and reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious legal, financial, and reputational consequences, including causing applicable bank regulatory authorities to not approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act (“SOX Act”) of 2002 addresses a broad range of corporate governance, auditing and accounting, executive compensation, and disclosure requirements for public companies and their directors and officers. The SOX Act requires our Chief Executive Officer and Chief Financial Officer to certify the accuracy of certain information included in our quarterly and annual reports. The rules require these officers to certify that they are responsible for establishing, maintaining, and regularly evaluating the effectiveness of our financial reporting and disclosure controls and procedures; that they have made certain disclosures to the auditors and to the Audit Committee of the Board of Directors about our controls and procedures; and that they have included information in their quarterly and annual filings about their evaluation and whether there have been significant changes to the controls and procedures or other factors which would significantly impact these controls subsequent to their evaluation. Section 404 of the SOX Act requires management to undertake an assessment of the adequacy and effectiveness of our internal controls over financial reporting and requires our auditors to attest to and report on the effectiveness of these controls.

Available Information

We file annual, quarterly, and current reports; proxy statements; and other information with the SEC. You may read and copy any document we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information about the public reference room. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information that issuers file electronically with the SEC. We maintain a website at www.firstcommunitybank.com that makes available, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and other information, including any amendments to those reports as soon as reasonably practicable after such reports are filed with, or furnished to, the SEC. You are encouraged to access these reports and other information about our business from the Investor Relations section of our website. The Investor Relations section contains information about our Board of Directors, executive officers, and corporate governance policies and principles, which include the charters of the standing committees of the Board of Directors, the Insider Trading Policy, and the Standards of Conduct governing our directors, officers, and employees. Information on our website is not incorporated by reference in this report.

Item 1A. Risk Factors.

The risk factors described below discuss potential events, trends, or other circumstances that could adversely affect our business, financial condition, results of operations, cash flows, liquidity, access to capital resources, and, consequently, cause the market value of our common stock to decline. These risks could cause our future results to differ materially from historical results and expectations of future financial performance. If any of the risks occur and the market price of our common stock declines significantly, individuals may lose all, or part, of their investment in our Company. Individuals should carefully consider our risk factors and information included, or incorporated by reference, in this report before making an investment decision. There may be risks and uncertainties that we have not identified or that we have deemed immaterial that could adversely affect our business; therefore, the following risk factors are not intended to be an exhaustive list of all risks we face.

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Risks Related to Our Business

The current economic environment poses significant challenges.

Our financial performance is generally highly dependent on the business environment in the markets we operate in and of the U.S. as a whole, which includes the ability of borrowers to pay interest, repay principal on outstanding loans, the value of collateral securing those loans, and demand for loans and other products and services we offer. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, low unemployment, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity, and investor or business confidence; limitations on the availability, or increases, in the cost of credit and capital; increases in inflation or interest rates; high unemployment; natural disasters; or a combination of these or other factors.

In recent years, economic growth and business activity across a wide range of industries has been slow and uneven. There are continuing concerns related to the level of U.S. government debt, fiscal actions that may be taken to address that debt, oil price volatility, global economic conditions, and significant uncertainty with respect to domestic and international fiscal and monetary policy. Economic pressure on consumers and uncertainty about continuing economic improvement may result in changes in consumer and business spending, borrowing, and savings habits. There can be no assurance that these conditions will improve or that these conditions will not worsen. Such conditions could adversely affect the credit quality of the Bank’s loans and the Company’s business, financial condition, and results of operations.

We operate in a highly regulated industry subject to examination, supervision, enforcement, and other legal actions by various federal and state governmental authorities, laws, and judicial and administrative decisions.

Congress and federal regulatory agencies continually review banking laws, regulations, and policies. Changes to these statutes, regulations, and regulatory policies, including changes in the interpretation or implementation, may cause substantial and unpredictable effects, require additional costs, limit the types of financial services and products offered, or allow non-banks to offer competing financial services and products. Failure to follow laws, regulations, and policies may result in sanctions by regulatory agencies and civil money penalties, which could have material adverse effects on our reputation, business, financial condition, and results of operations. We have policies and procedures designed to prevent violations; however, there is no assurance that violations will not occur. Existing and future laws, regulations, and policies yet to be adopted may make compliance more difficult or expensive; restrict our ability to originate, broker, or sell loans; further limit or restrict commissions, interest, and other charges earned on loans we originate or sell; and adversely affect our business, financial condition, and results of operations.

The Bank's ability to pay dividends is subject to regulatory limitations that may affect the Company's ability to pay expenses and dividends to shareholders.

The Company is a legal entity that is separate and distinct from its subsidiaries. The Company depends on the Bank and its other subsidiaries for cash, liquidity, and the payment of dividends to the Company to pay operating expenses and dividends to stockholders. There is no assurance that the Bank will have the capacity to pay dividends to the Company in the future or that the Company will not require dividends from the Bank to satisfy obligations. The Bank's dividend payment is governed by various statutes and regulations. For additional information, see "Payment of Dividends" in Item 1 of this report. The Company may not be able to service obligations as they become due if the Bank is unable to pay dividends sufficient to satisfy the Company's obligations, including our common stock. Consequently, the inability to receive dividends from the Bank could adversely affect the Company's financial condition, results of operations, cash flows, and prospects.

We face strong competition from other financial institutions, financial service companies, and organizations that offer services similar to our offerings.

Our larger competitors may have substantially greater resources and lending limits, name recognition, and market presence that allow them to offer products and services that we do not offer and to price loans and deposits more aggressively than we do. The expansion of non-bank competitors, which may have fewer regulatory constraints and lower cost structures, over recent years has intensified competitive pressures on core deposit generation and retention. For additional information, see "Competition" in Item 1 of this report. Our success depends, in part, on our ability to attract and retain customers by adapting our products and services to evolving customer needs and industry and economic conditions. Failure to perform in any of these areas could weaken our competitive position, reduce deposits and loan originations, and adversely affect our financial condition, results of operations, cash flows, and prospects.

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We may require additional capital in the future that may not be available when needed.

We may need to raise additional capital to strengthen our capital position, increase our liquidity, satisfy obligations, or pursue growth objectives. Our ability to raise additional capital depends on current conditions in capital markets, which are outside our control, and our financial performance. Certain economic conditions and declining market confidence may increase our cost of funds and limit our access to customary sources of capital, such as borrowings with other financial institutions, repurchase agreements, and availability under the FRB's Discount Window. Events that limit access to capital markets and the inability to obtain capital may have a materially adverse effect on our business, financial condition, results of operations, and market value of common stock. We cannot provide any assurance that additional capital will be available, on acceptable terms or at all, in the future.

Liquidity risk could impair our ability to fund operations.

Liquidity is essential to our business and the inability to raise funds through deposits, borrowings, equity and debt offerings, or other sources could have a materially adverse effect on our liquidity. Company specific factors such as a decline in our credit rating, an increase in the cost of capital from financial capital markets, a decrease in business activity due to adverse regulatory action or other company specific event, or a decrease in depositor or investor confidence may impair our access to funding with acceptable terms adequate to finance our activities. General factors related to the financial services industry such as a severe disruption in financial markets, a decrease in industry expectations, or a decrease in business activity due to political or environmental events may impair our access to liquidity.

We are subject to interest rate risk.

Interest rate risk results principally when interest-earning assets and interest-bearing liabilities reprice at differing times, when underlying rates change at different levels or in varying degrees, when there is an unequal change in the spread between two or more rates for different maturities, and when embedded options, if any, are exercised. Our earnings and cash flows are largely dependent upon net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies, particularly, the Federal Reserve. Changes in monetary policy and interest rates could influence the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings. Further, such changes could also affect our ability to originate loans and obtain deposits and the fair value of our financial assets and liabilities. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income and earnings could be adversely affected. Conversely, if interest rates received on loans and other investments fall more quickly than interest rates paid on deposits and other borrowings, our net interest income and earnings could also be adversely affected.

Our accounting estimates and risk management processes rely on analytical and forecasting models.

The processes we use to estimate probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depend upon analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset/liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models used for determining probable loan losses are inadequate, the allowance for loan losses may not be sufficient to cover actual loan losses and an increase in the loan loss provision could materially and adversely affect our operating results. Federal regulatory agencies regularly review our loans and allowance for loan losses as an integral part of the examination process. There is no assurance that we will not, or that regulators will not require us to, increase our allowance in future periods, which could materially and adversely affect our earnings and profitability. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon the sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition, and results of operations. For additional information, see “Fair Value Measurements” and “Allowance for Loan Losses” in the “Critical Accounting Estimates” section in Part II, Item 7 and Note 1, “Basis of Presentation and Accounting Policies,” to the Consolidated Financial Statements in Part II, Item 8 of this report.

Changes in the fair value of our investment securities may reduce stockholders' equity and net income.

A decline in the estimated fair value of the investment portfolio may result in a decline in stockholders' equity, book value per common share, and tangible book value per common share. Unrealized losses are recorded even though the securities are not sold or held for sale. If a debt security is never sold and no credit impairment exists, the decrease is recovered at the security's maturity. Equity securities have no stated maturity; therefore, declines in fair value may or may not be recovered over time. We conduct quarterly reviews of our securities portfolio to determine if unrealized losses are temporary or other than temporary. No assurance can be given that we will not need to recognize other-than-temporary impairment ("OTTI") charges in the future. Additional OTTI charges may materially affect our financial condition and earnings. For additional information, see "Investment Securities" in the "Critical Accounting Estimates" section in Part II, Item 7 and Note 1, "Basis of Presentation and Accounting Policies," and Note 3, "Investment Securities," to the Consolidated Financial Statements in Part II, Item 8 of this report.

We are subject to credit risk associated with the financial condition of other financial institutions.

Credit risk is the risk of not collecting payments pursuant to the contractual terms of loans, leases and investment securities. Financial institutions are interrelated as a result of trading, clearing, counterparty, and other relationships. We have exposure to different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, investment companies, and other institutional clients. Our ability to engage in routine funding transactions could be adversely affected by the failure, actions, and commercial soundness of other financial institutions. These transactions may expose us to credit risk if our counterparty or client defaults on their contractual obligation. Our credit risk may increase if the collateral we hold cannot be realized or liquidated at prices sufficient to recover the full amount of the loan or derivative exposure due to us. In the event of default, we may be required to provide collateral to secure the obligation to the counterparties. In the event of a bankruptcy or insolvency proceeding involving one of such counterparties, we may experience delays in recovering the assets posted as collateral or may incur a loss to the extent that the counterparty was holding collateral in excess of the obligation to such counterparty. Losses from routine funding transactions could have a material adverse effect on our financial condition and results of operations.

Our commercial loan portfolio may expose us to increased credit risk.

Commercial business and real estate loans generally have a higher risk of loss because loan balances are typically larger than residential real estate and consumer loans and repayment is usually dependent on cash flows from the borrower's business or the property securing the loan. Our commercial business loans are primarily made to small business and middle market customers. As of December 31, 2017, commercial business and real estate loans totaled $1.01 billion, or 55.52%, of our total loan portfolio. As of the same date, our largest outstanding commercial business loan was $6.15 million and largest outstanding commercial real estate loan was $11.01 million. Commercial construction loans generally have a higher risk of loss due to the assumptions used to estimate the value of property at completion and the cost of the project, including interest. If the assumptions and estimates are inaccurate, the value of completed property may fall below the related loan amount. As of December 31, 2017, commercial construction loans totaled $60.06 million, or 3.30% of our total loan portfolio. As of the same date, our largest outstanding commercial construction loan was $5.79 million. Losses from our commercial loan portfolio could have a material adverse effect on our financial condition and results of operations.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. In the ordinary course of business, we foreclose on and take title to properties that secure certain loans. Hazardous or toxic substances could be found on properties we own. If substances are present, we may be liable for remediation costs, personal injury claims, and property damage and our ability to use or sell the property would be limited. We have policies and procedures in place that require environmental reviews before initiating foreclosure actions on real property; however, these reviews may not detect all potential environmental hazards. Environmental laws that require us to incur substantial remediation costs, which could materially reduce the affected property's value, and other liabilities associated with environmental hazards could have a material adverse effect on our financial condition and results of operations.

Potential acquisitions may disrupt our business and dilute stockholder value.

We may seek merger or acquisition partners that are culturally similar, have experienced management, and possess either significant market presence or the potential for improved profitability through financial management, economies of scale, or expanded services. Risks inherent in acquiring other banks, businesses, and banking branches may include the following:

- potential exposure to unknown or contingent liabilities of the target company;
- exposure to potential asset quality issues of the target company;
- difficulty, expense, and delays of integrating the operations and personnel of the target company;
- potential disruption to our business;
- potential diversion of management's time and attention;

- loss of key employees and customers of the target company;
- difficulty in estimating the value of the target company;
- potential changes in banking or tax laws or regulations that may affect the target company;
- unexpected costs and delays;
- the target company's performance does not meet our growth and profitability expectations;
- limited experience in new markets or product areas;
- increased time, expenses, and personnel as a result of strain on our infrastructure, staff, internal controls, and management; and
- potential short-term decreases in profitability.

We regularly evaluate merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving the payment of cash or the issuance of debt or equity securities may occur at any time. Acquisitions typically involve goodwill, a purchase premium over the acquired company's book and market values; therefore, dilution of our tangible book value and net income per common share may occur. If we are unable to realize revenue increases, cost savings, geographic or product presence growth, or other projected benefits from acquisitions, our financial condition and results of operations may be adversely affected.

Attractive acquisition opportunities may not be available in the future.

We expect banking and financial companies, which may have significantly greater resources, to compete for the acquisition of financial service businesses. This competition could increase the price of potential acquisitions that we believe are attractive. If we fail to receive proper regulatory approval, we will not be able to consummate an acquisition. Our regulators consider our capital, liquidity, profitability, regulatory compliance, level of goodwill and intangible assets, and other factors when considering acquisition and expansion proposals. Future acquisitions may be dilutive to our earnings and equity per share of our common stock.

We may experience future goodwill impairment.

We test goodwill for impairment annually, or more often if necessary, using quantitative and qualitative factors. Impairment charges may cause an adverse effect on our earnings and financial position. For additional information, see "Intangible Assets" in the "Critical Accounting Estimates" section in Part II, Item 7 and Note 1, "Basis of Presentation and Accounting Policies," and Note 9, "Goodwill and Other Intangible Assets," to the Consolidated Financial Statements in Part II, Item 8 of this report.

We are subject to certain obligations under FDIC loss share agreements that specify how to manage, service, report, and request reimbursement for losses incurred on covered assets.

Our ability to receive benefits under FDIC loss share agreements is subject to compliance with certain requirements, oversight and interpretation, and contractual term limitations. Our obligations under loss share agreements are extensive, and failure to follow any obligations could result in a specific asset, or group of assets, losing loss share coverage. Reimbursement requests are subject to FDIC review and may be delayed or disallowed if we do not comply with our obligations. Losses projected to occur during the loss share term may not be realized until after the expiration of the applicable agreement; consequently, those losses may have a material adverse impact on our results of operations. Our current loss estimates only include those projected to occur during the loss share period and for which we expect reimbursement from the FDIC at the applicable reimbursement rate. We are subject to FDIC audits to ensure compliance with the loss share agreements. The loss share agreements are subject to interpretation by the FDIC and us; therefore, disagreements about the coverage of losses, expenses, and contingencies may arise. The realization of benefits to be received from the FDIC ultimately depends on the performance of the underlying covered assets, the passage of time, claims paid by the FDIC, and interpretation; therefore, the amount received could differ materially from the carrying value of expected reimbursements and have a material effect on our financial condition and results of operations. For additional information, see “FDIC Indemnification Asset” in the “Critical Accounting Estimates” section in Part II, Item 7 and Note 1, “Basis of Presentation and Accounting Policies,” and Note 7, “FDIC Indemnification Asset,” to the Consolidated Financial Statements in Part II, Item 8 of this report.

We may be required to pay higher FDIC insurance premiums or special assessments.

Our deposits are insured up to applicable limits by the DIF of the FDIC and we are subject to deposit insurance assessments to maintain the DIF. For additional information, see “Deposit Insurance and Assessments” in Item 1 of this report. We are unable to predict future insurance assessment rates; however, deterioration in our risk-based capital ratios or adjustments to base assessment rates may result in higher insurance premiums or special assessments. The deterioration of banking and economic conditions and financial institution failures deplete the FDIC’s DIF and reduce the ratio of reserves to insured deposits. If the DIF is unable to meet funding requirements, increases in deposit insurance premium rates or special assessments may be required. Future assessments, increases, or required prepayments related to FDIC insurance premiums may negatively affect our financial condition and results of operations.

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The repeal of the federal prohibitions on payment of interest on demand deposits could increase our interest expense.

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. We do not know what interest rates other institutions may offer as market interest rates begin to increase. Our interest expense will increase and net interest margin will decrease if we offer interest on demand deposits to attract additional customers or maintain current customers, which could have a material adverse effect on our business, financial condition, and results of operations.

We may lose members of our management team and have difficulty attracting skilled personnel.

Our success depends, in part, on our ability to attract and retain key employees. Competition for the best people can be intense. The unexpected loss of key personnel could have a material adverse impact on our business due to the loss of certain skills, market knowledge, and industry experience and the difficulty of promptly finding qualified replacement personnel. Certain existing and proposed regulatory guidance on compensation may also negatively affect our ability to retain and attract skilled personnel.

Our internal controls and procedures may fail or be circumvented.

We review our internal controls over financial reporting quarterly and enhance controls in response to these assessments, internal and external audit, and regulatory recommendations. A control system, no matter how well conceived and operated, includes certain assumptions and can only provide reasonable assurance that the objectives of the control system are met. These controls may be circumvented by individual acts, collusion, or management override. Any failure or circumvention related to our controls and procedures or failure to follow regulations related to controls and procedures could have a material adverse effect on our business, reputation, results of operations, and financial condition.

We continue to encounter technological change and are subject to information security risks associated with technology.

The financial services industry continues to experience rapid technological change with the introduction of new, and increasingly complex, technology-driven products and services. The effective use of technology increases operational efficiency that enables financial service institutions to reduce costs. Our future success depends, in part, on our ability to provide products and services that satisfactorily meet the financial needs of our customers, as well as to realize additional efficiencies in our operations. We may fail to use technology-driven products and services effectively to better serve our customers and increase operational efficiency or sufficiently invest in technology solutions and upgrades to ensure systems are operating properly. Further, many of our competitors have substantially greater resources to invest in technology, which may adversely affect our ability to compete.

We rely on electronic communications and information systems, including those provided by third-party vendors, to conduct our business operations. Our security risks increase as our reliance on technology increases; consequently, the expectation to safeguard information by monitoring systems for potential failures, disruptions, and breakdowns has also increased. Risks associated with technology include security breaches, operational failures and service interruptions, and reputational damages. These risks also apply to our third-party service providers. Our third-party vendors include large entities with significant market presence in their respective fields; therefore, their services could be difficult to replace quickly if there are operational failures or service interruptions.

We rely on our technology-driven systems to conduct daily business and accounting operations that include the collection, processing, and retention of confidential financial and client information. We may be vulnerable to security breaches, such as employee error, cyber-attacks, and viruses, beyond our control. In addition to security breaches, programming errors, vandalism, natural disasters, terrorist attacks, and third-party vendor disruptions may cause operational failures and service interruptions to our communication and information systems. Further, our systems may be temporarily disrupted during implementation or upgrade. Security breaches and service interruptions related to our information systems could damage our reputation, which may cause us to lose customers, subject us to regulatory scrutiny, or expose us to civil litigation and financial liability.

Our customers and employees have been, and will continue to be, targeted by parties using fraudulent e-mails and other communications in attempts to misappropriate passwords, bank account information or other personal information, or to introduce viruses or other malware through "Trojan horse" programs to our information systems and/or our customers' computers. Though we endeavor to mitigate these threats through product improvements, use of encryption and authentication technology, and customer and employee education, such cyber-attacks against us or our merchants and our third-party service providers remain a serious issue. The pervasiveness of cybersecurity incidents in general and the risks of cyber-crime are complex and continue to evolve. More generally, publicized information about security and cyber-related problems could inhibit the use or growth of electronic or web-based applications or solutions as a means of conducting commercial transactions.

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While we have not experienced a significant compromise, significant data loss, or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Although we make significant efforts to maintain the security and integrity of our information systems and have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well protected information, networks, systems and facilities remain potentially vulnerable because attempted security breaches, particularly cyber-attacks and intrusions, or disruptions will occur in the future, and because the techniques used in such attempts are constantly evolving and generally are not recognized until launched against a target, and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures, and thus it is virtually impossible for us to entirely mitigate this risk. A security breach or other significant disruption of our information systems or those related to our customers, merchants and our third-party vendors, including as a result of cyber-attacks, could (1) disrupt the proper functioning of our networks and systems and therefore our operations and/or those of our customers; (2) result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers; (3) result in a violation of applicable privacy, data breach and other laws, subjecting us to additional regulatory scrutiny and expose us to civil litigation, governmental fines and possible financial liability; (4) require significant management attention and resources to remedy the damages that result; or (5) harm our reputation or cause a decrease in the number of customers who choose to do business with us. The occurrence of any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

We may be subject to claims and litigation pertaining to intellectual property.

Banking and other financial services companies, such as the Company, rely on technology companies to provide information technology products and services necessary to support the Company’s day-to-day operations. Technology companies often enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. In addition, patent holding companies seek to monetize patents they have purchased or otherwise obtained. Competitors of the Company’s vendors, or other individuals or companies, have from time to time claimed to hold intellectual property sold to the Company by its vendors. Such claims may increase in the future as the financial services sector becomes more reliant on information technology vendors. The plaintiffs in these actions often seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, the Company may have to engage in protracted litigation. Such litigation is often expensive, time consuming, disruptive to the Company’s operations, and distracting to management. If the Company is found to have infringed on one or more patents or other intellectual property rights, it may be required to pay substantial damages or royalties to a third party. In certain cases, the Company may consider entering into licensing agreements for disputed intellectual property, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. These licenses may also significantly increase the Company’s operating expenses. If legal matters related to intellectual property claims were resolved against the Company or settled, the Company could be required to make payments in amounts that could have a material adverse effect on its business, financial condition, and results of operations.

Risks Related to Our Common Stock

The market price of our common stock may be volatile.

Stock price volatility may make it more difficult for our stockholders to resell their common stock when desired. Our common stock price may fluctuate significantly due to a variety of factors that include the following:

- actual or expected variations in quarterly results of operations;
- recommendations by securities analysts;
- operating and stock price performance of comparable companies, as deemed by investors;
- news reports relating to trends, concerns, and other issues in the financial services industry;
- perceptions in the marketplace about our Company or competitors;
- new technology used, or services offered, by competitors;

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- significant acquisitions or business combinations, strategic partnerships, joint ventures, or capital commitments by, or involving, our Company or competitors;
- failure to integrate acquisitions or realize expected benefits from acquisitions;
- changes in government regulations; and
- geopolitical conditions, such as acts or threats of terrorism or military action.

General market fluctuations; industry factors; political conditions; and general economic conditions and events, such as economic slowdowns, recessions, interest rate changes, or credit loss trends, could also cause our common stock price to decrease regardless of operating results.

The trading volume in our common stock is less than that of other larger financial services companies.

Although our common stock is listed for trading on the NASDAQ, the trading volume in our common stock is less than that of other, larger financial services companies. A public trading market having the desired characteristics of depth, liquidity, and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock or the expectation of these sales could cause our stock price to fall.

We may not continue to pay dividends on our common stock in the future.

Our common stockholders are only entitled to receive dividends when declared by our Board of Directors from funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so, and may reduce or eliminate our common stock dividend in the future. This could adversely affect the market price of our common stock. As a financial holding company, the Company's ability to declare and pay dividends is dependent on certain federal regulatory considerations, including the guidelines of the Federal Reserve about capital adequacy and dividends. For additional information, see "Payment of Dividends" in Item 1 of this report.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

We own our corporate headquarters located at One Community Place, Bluefield, Virginia. As of December 31, 2017, the Bank provided financial services through a network of 44 branch locations in West Virginia (18 branches), Virginia (19 branches), North Carolina (5 branches), and Tennessee (2 branches). We own 42 of these branches and lease the remaining 2 branches. We also lease a loan production office and own a wealth management office and a call center location. As of December 31, 2017, there were no mortgages or liens against any properties. We believe that our properties are suitable and adequate to serve as financial services facilities. A list of all branch and ATM locations is available on our website at www.firstcommunitybank.com. Information contained on our website is not part of this report. For additional information, see Note 8, “Premises, Equipment, and Leases,” to the Consolidated Financial Statements in Part II, Item 8 of this report.

Item 3. Legal Proceedings.

We are currently a defendant in various legal actions and asserted claims in the normal course of business. Although we are unable to assess the ultimate outcome of each of these matters with certainty, we are of the belief that the resolution of these actions should not have a material adverse effect on our financial position, results of operations, or cash flows.

Item 4. Mine Safety Disclosures.

None.

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PART II

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

Market Information, Holders, and Dividends

Our common stock is traded on the NASDAQ Global Select Market under the symbol FCBC. As of February 28, 2018, there were 2,337 record holders and 16,945,756 outstanding shares of our common stock. The following table presents the high and low stock prices and cash dividends paid per share of our common stock for the periods indicated:

	Year Ended December 31, 2017			2016		
	Sale Price		Cash Dividends per Common Share	Sale Price		Cash Dividends per Common Share
	High	Low		High	Low	
First quarter	$30.86	$23.23	$ 0.16	$19.93	$16.67	$ 0.14
Second quarter	28.80	24.06	0.16	22.74	19.03	0.14
Third quarter	29.80	24.02	0.18	25.24	21.53	0.16
Fourth quarter	32.24	26.97	0.18	31.94	20.47	0.16

Common stock cash dividends totaled $11.56 million in 2017, $10.40 million in 2016, and $9.99 million in 2015. Cash dividends paid per common share totaled $0.68 in 2017, $0.60 in 2016, and $0.54 in 2015. The Company's ability to pay dividends on its common stock is dependent on the Bank's ability to pay dividends to the Company, which is subject to various regulatory restrictions and limitations. For additional information, see "Payment of Dividends" in Part I, Item 1 of this report.

During the first quarter of 2015, the Company notified holders of its 6% Series A Noncumulative Convertible Preferred Stock ("Series A Preferred Stock") of its intent to redeem all of the outstanding shares. Prior to redemption, holders converted 12,784 shares of Series A Preferred Stock with each share convertible into 69 shares of the

Company's common stock. The Company redeemed the remaining 2,367 shares for $2.37 million along with accrued and unpaid dividends of $9 thousand. As a result of the redemption, there were no shares of Series A Preferred Stock outstanding as of December 31, 2017, December 31, 2016, or December 31, 2015. Series A Preferred Stock cash dividends totaled $105 thousand in 2015.

Purchases of Equity Securities

We repurchased 50,118 shares of our common stock in 2017, 1,182,294 shares in 2016, and 1,238,299 shares in 2015. The following table provides information about purchases of our common stock made by us or on our behalf by any affiliated purchaser, as defined in Rule 10b-18(a)(3) under the Exchange Act, during the periods indicated:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Maximum Number of Shares that May Yet be Purchased Under the Plan(1)
October 1-31, 2017	-	$ -	-	613,071
November 1-30, 2017	-	-	-	613,071
December 1-31, 2017	-	-	-	616,447
Total	-	$ -	-	

(1) Our stock repurchase plan, as amended, authorizes the purchase and retention of up to 5,000,000 shares. The plan has no expiration date and is currently in effect. No determination has been made to terminate the plan or to cease making purchases. We held 4,383,553 shares in treasury as of December 31, 2017.

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Stock Performance Graph

The following graph, compiled by SNL Financial LC ("SNL"), compares the cumulative total shareholder return on our common stock for the five years ended December 31, 2017, with the cumulative total return of the S&P 500 Index, the NASDAQ Composite Index, and SNL's Asset Size & Regional Peer Group. The Asset Size & Regional Peer Group consists of 48 bank holding companies with total assets between $1 billion and $5 billion that are located in the Southeast Region of the United States and traded on NASDAQ, the OTC Bulletin Board, and pink sheets. The cumulative returns assume that $100 was originally invested on December 31, 2012, and that all dividends are reinvested.

	Year Ended December 31,					
	2012	**2013**	**2014**	**2015**	**2016**	**2017**
First Community Bancshares, Inc.	100.00	107.80	109.87	128.17	213.40	208.43
S&P 500 Index	100.00	132.39	150.51	152.59	170.84	208.14
NASDAQ Composite Index	100.00	140.12	160.78	171.97	187.22	242.71
SNL Asset & Regional Peer Group(1)	100.00	119.35	130.28	146.71	196.01	220.52

(1) Includes the following institutions: Access National Corporation; American National Bankshares Inc.; Atlantic Capital Bancshares, Inc.; Bear State Financial, Inc.; Burke & Herbert Bank & Trust Company; C&F Financial Corporation; Capital City Bank Group, Inc.; CapStar Financial; Holdings, Inc.; Carolina Financial Corporation; Carter Bank & Trust; Charter Financial Corporation; Citizens Holding Company; City Holding Company; CNB Corporation; Colony Bankcorp, Inc.; Community Bankers Trust Corporation; Entegra Financial Corp.; Fidelity Southern Corporation; First Bancorp; First Bancorp, Inc.; First Bancshares, Inc.; First Citizens Bancshares, Inc.; First Community Bancshares, Inc.; First Farmers and Merchants Corporation; Hamilton State Bancshares, Inc.; HomeTrust Bancshares, Inc.; Live Oak Bancshares, Inc.; MetroCity Bankshares, Inc.; MVB Financial Corp.; National Bankshares, Inc.; National Commerce Corporation; Paragon Commercial Corporation; Peoples Bancorp of North Carolina, Inc.; Premier Financial Bancorp, Inc.; Reliant Bancorp, Inc.; SmartFinancial, Inc.; Southern BancShares (N.C.), Inc.; Southern First Bancshares, Inc.; Southern National Bancorp of Virginia, Inc.; Summit Financial Group, Inc.; TGR Financial, Inc.; and Wilson Bank Holding Co.

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Item 6. Selected Financial Data.

The following table presents selected consolidated financial data, derived from the audited financial statements, as of and for the five years ended December 31, 2017. This information should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Item 8, "Financial Statements and Supplementary Data," of this report.

	Year Ended December 31,				
(Amounts in thousands, except share and per share data)	**2017**	**2016**	**2015**	**2014**	**2013**
Selected Balance Sheet Data					
Investment securities	$190,729	$212,712	$438,714	$384,065	$520,388
Loans	1,817,184	1,852,948	1,706,541	1,691,208	1,711,604
Allowance for loan losses	19,276	17,948	20,233	20,227	24,077
Total assets	2,388,460	2,386,398	2,462,276	2,607,936	2,602,514
Average assets	2,370,321	2,455,458	2,520,934	2,608,570	2,661,602
Deposits	1,929,891	1,841,338	1,873,259	2,000,759	1,950,742
Borrowings	80,086	178,713	219,370	229,741	300,396
Total liabilities	2,037,746	2,047,341	2,119,259	2,256,562	2,273,908
Preferred stock	-	-	-	15,151	15,251
Total stockholders' equity	350,714	339,057	343,017	351,374	328,606
Average stockholders' equity	349,701	338,475	348,199	342,619	355,611
Summary of Operations					
Interest income	$95,308	$94,724	$96,102	$106,108	$109,476
Interest expense	8,090	9,844	11,349	15,290	17,834
Net interest income	87,218	84,880	84,753	90,818	91,642
Provision for loan losses	2,771	1,255	2,191	145	8,208
Noninterest income	26,248	27,066	29,530	30,003	29,771
Noninterest expense	68,582	72,746	76,171	82,862	78,985
Income tax expense	20,628	12,819	11,381	12,324	10,908
Net income	21,485	25,126	24,540	25,490	23,312
Dividends on preferred stock	-	-	105	910	1,024
Net income available to common shareholders	21,485	25,126	24,435	24,580	22,288
Selected Share and Per Share Data					
Basic earnings per common share	$1.26	$1.45	$1.32	$1.34	$1.13
Diluted earnings per common share	1.26	1.45	1.31	1.31	1.11
Cash dividends per common share	0.68	0.60	0.54	0.50	0.48
Book value per common share at year-end[(1)]	20.63	19.95	18.95	18.06	16.79
Weighted average basic shares outstanding	17,002,116	17,319,689	18,531,039	18,406,363	19,792,099

Weighted average diluted shares outstanding	17,077,842		17,365,524		18,727,464		19,483,054		20,961,800	
Selected Ratios										
Return on average assets	0.91	%	1.02	%	0.97	%	0.94	%	0.84	%
Return on average common equity	6.14	%	7.42	%	7.08	%	7.51	%	6.57	%
Average equity to average assets	14.75	%	13.78	%	13.81	%	13.13	%	13.36	%
Dividend payout	53.81	%	41.36	%	40.95	%	37.44	%	42.62	%
Common equity Tier 1 ratio(2)	13.98	%	13.88	%	14.54	%	NA		NA	
Total risk-based capital ratio	15.06	%	15.79	%	15.95	%	17.68	%	16.44	%
Tier 1 risk-based capital ratio	13.98	%	14.74	%	14.73	%	16.43	%	15.19	%
Tier 1 leverage ratio	11.06	%	11.07	%	10.62	%	10.12	%	9.95	%

(1) Book value per common share is defined as stockholders' equity divided by as-converted common shares outstanding.
(2) The common equity Tier 1 ratio became effective on January 1, 2015.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand our financial condition, changes in financial condition, and results of operations. MD&A contains forward-looking statements and should be read in conjunction with our consolidated financial statements, accompanying notes, and other financial information included in this report. Unless the context suggests otherwise, the terms "First Community," "Company," "we," "our," and "us" refer to First Community Bancshares, Inc. and its subsidiarie as a consolidated entity.

Executive Overview

First Community Bancshares, Inc. (the "Company") is a financial holding company, headquartered in Bluefield, Virginia, that provides banking products and services through its wholly owned subsidiary First Community Bank (the "Bank"), a Virginia chartered bank institution. As of December 31, 2017, the Bank operated 44 branches as First Community Bank in Virginia, West Virginia, and North Carolina and as People's Community Bank, a Division of First Community Bank, in Tennessee. Our primary source of earnings is net interest income, the difference between interest earned on assets and interest paid on liabilities, which is supplemented by fees for services, commissions on sales, and various deposit service charges. We fund our lending and investing activities primarily through the retail deposit operations of our branch banking network and, to a lesser extent, retail and wholesale repurchase agreements and Federal Home Loan Bank ("FHLB") borrowings. We invest our funds primarily in loans to retail and commercial customers and various investment securities.

The Bank offers trust management, estate administration, and investment advisory services through its Trust Division and wholly owned subsidiary First Community Wealth Management ("FCWM"). The Trust Division manages inter vivos trusts and trusts under will, develops and administers employee benefit and individual retirement plans, and manages and settles estates. Fiduciary fees for these services are charged on a schedule related to the size, nature, and complexity of the account. Revenues consist primarily of commissions on assets under management and investment advisory fees. As of December 31, 2017, the Trust Division and FCWM managed $957 million in combined assets under various fee-based arrangements as fiduciary or agent.

The Bank offers insurance products and services through its wholly owned subsidiary First Community Insurance Services ("FCIS"). FCIS provides in-branch commercial and insurance services in Virginia and West Virginia. Revenues are primarily derived from commissions paid by issuing companies on the sale of policies.

Our acquisition and divestiture activity during the three years ended December 31, 2017, includes the sale of Greenpoint Insurance Group, Inc. ("Greenpoint") to Ascension Insurance Agency, Inc. on October 31, 2016, and the simultaneous sale of six branches to and purchase of seven branches from First Bank on July 15, 2016. For additional information, see Note 2, “Acquisitions and Divestitures,” to the Consolidated Financial Statements in Item 8 of this report.

Critical Accounting Estimates

Our consolidated financial statements are prepared in conformity with generally accepted accounting principles (“GAAP”) in the U.S. and prevailing practices in the banking industry. Our accounting policies, as presented in Note 1, “Basis of Presentation and Accounting Policies,” to the Consolidated Financial Statements in Item 8 of this report are fundamental in understanding MD&A and the disclosures presented in Item 8, “Financial Statements and Supplementary Data,” of this report. Management may be required to make significant estimates and assumptions that have a material impact on our financial condition or operating performance. Due to the level of subjectivity and the susceptibility of such matters to change, actual results could differ significantly from management’s assumptions and estimates. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates used, we have identified fair value measurements, investment securities, the allowance for loan losses, goodwill and other intangible assets, and income taxes as the accounting areas that require the most subjective or complex judgments or are the most susceptible to change.

Fair Value Measurements

We use the fair value hierarchy to determine the fair value of certain assets and liabilities. The hierarchy consists of three levels that include valuations based on observable quoted prices in active markets; quoted prices in inactive markets or other observable inputs, such as third-party sources; and unobservable inputs. When quoted prices or third-party information is not available, management estimates valuation adjustments primarily through the use of financial modeling techniques and appraisal estimates. The assumptions and estimates used to determine fair value may be highly subjective in nature, such as cash flow estimates, risk characteristics, credit quality measurements, and interest rates; therefore, valuations may not be precise. The amounts realized or paid on the settlement or maturity of fair value instruments may be significantly different from estimates. While management believes our valuation methodologies are appropriate and consistent with other market participants, different methodologies or assumptions used to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. For additional information, see Note 17, “Fair Value,” to the Consolidated Financial Statements in Item 8 of this report.

Investment Securities

We review our investment portfolio quarterly for indications of other-than-temporary impairment (“OTTI”). We use inputs from independent third parties to determine the fair value of investment securities, which are reviewed and corroborated by management. Unrealized losses are evaluated to determine whether the impairment is temporary or other-than-temporary in nature. For debt securities, we consider our intent to sell the securities, the evidence available to determine if it is more likely than not that we will have to sell the securities before recovery of amortized cost, and the probable credit losses. Probable credit losses are evaluated using the present value of expected future cash flows; the severity and duration of the impairment; the issuer’s financial condition and near-term prospects to service the debt; the cause of the decline, such as adverse conditions related to the issuer, the industry, or economic environment; the payment structure of the debt; the issuer’s failure to make scheduled interest or principal payments; and any change in the issuer’s credit rating by rating agencies. If the present value of expected future cash flows discounted at the security's effective yield is less than the net book value, the difference is recognized as a credit-related OTTI in noninterest income. If we do not intend to sell and if we are not likely to be required to sell the security, the OTTI is separated into an amount representing the credit loss, which is recognized as a charge to noninterest income, and the amount representing all other factors, which is recognized in other comprehensive income (“OCI”). For equity securities, we consider our intent and ability to hold the security to recovery; the severity and duration of the impairment; the issuer’s financial condition, capital strength, and near-term prospects; and any change in the issuer’s credit rating by rating agencies. If the fair value of the security is less than the net book value, the OTTI is recognized as a charge to noninterest income. For additional information, see Note 3, “Investment Securities,” to the Consolidated Financial Statements in Item 8 of this report.

Allowance for Loan Losses

We review our allowance for loan losses quarterly to determine if it is sufficient to absorb probable loan losses in the portfolio. This determination requires management to make significant estimates and assumptions. While management uses its best judgment and available information, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the performance of our loan portfolio, the economy, changes in interest rates, and the view of regulatory authorities towards loan classifications. These uncertainties may result in material changes to the allowance for loan losses in the near term; however, the amount of the change cannot reasonably be estimated.

Our allowance for loan losses consists of reserves assigned to specific loans and credit relationships and general reserves assigned to loans not separately identified that have been segmented into groups with similar risk characteristics using our internal risk grades. General reserve allocations are based on management’s judgments of qualitative and quantitative factors about macro and micro economic conditions reflected within the loan portfolio and the economy. Factors considered in this evaluation include, but are not limited to, probable losses from loan and other credit arrangements, general economic conditions, changes in credit concentrations or pledged collateral, historical loan loss experience, and trends in portfolio volume, maturities, composition, delinquencies, and nonaccruals. Historical loss rates for each risk grade of commercial loans are adjusted by environmental factors to estimate the amount of reserve needed by segment. Individually significant loans require additional analysis that may include the borrower’s underlying cash flow and capacity for debt repayment, specific business conditions, and value of secondary sources of repayment; consequently, this analysis may result in the identification of weakness and a corresponding need for a specific reserve. No allowance for loan losses is carried over or established at acquisition for purchased loans acquired in business combinations. A provision for loan losses is recorded for any credit deterioration in purchased performing loans after the acquisition date. Loans acquired in business combinations that are deemed impaired at acquisition, purchased credit impaired (“PCI”) loans, are grouped into pools and evaluated separately from the non-PCI portfolio. The estimated cash flows to be collected on PCI loans are discounted at a market rate of interest. Management believed the allowance was adequate to absorb probable loan losses inherent in the loan portfolio as of December 31, 2017. For additional information, see Note 6, “Allowance for Loan Losses,” to the Consolidated Financial Statements in Item 8 of this report.

Third-party collateral valuations are regularly obtained and evaluated to help management determine changes in cash flows on purchased loans acquired in business combinations, potential credit impairment, and the amount of impairment to record. Internal collateral valuations are generally performed within two to four weeks of identifying the initial potential impairment. The internal evaluation compares the original appraisal to current local real estate market conditions and considers experience and expected liquidation costs. When a third-party evaluation is received, it is reviewed for reasonableness. Once the evaluation is reviewed and accepted, discounts are applied to fair market value, based on, but not limited to, our historical liquidation experience for like collateral, resulting in an estimated net realizable value. The estimated net realizable value is compared to the outstanding loan balance to determine the appropriate amount of specific impairment reserve. Specific reserves are generally recorded for impaired loans while third-party evaluations are in process and for impaired loans that continue to make some form of payment. While waiting for receipt of the third-party appraisal, we regularly review the relationship to identify any potential adverse developments and begin the tasks necessary to gain control of the collateral and prepare it for liquidation, including, but not limited to, engagement of counsel, inspection of collateral, and continued communication with the borrower. Generally, the only difference between current appraised value, adjusted for liquidation costs, and the carrying amount of the loan, less the specific reserve, is any downward adjustment to appraised value that we determine appropriate, such as the costs to sell the property. Impaired loans that do not meet certain criteria and do not have a specific reserve have typically been written down through partial charge-offs to net realizable value. Based on prior experience, the Company rarely returns loans to performing status after they have been partially charged off. Impaired credits move quickly through the process towards ultimate resolution except in cases involving bankruptcy and various state judicial processes, which may extend the time for ultimate resolution.

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Goodwill and Other Intangible Assets

We test goodwill annually, or more frequently if necessary, using a qualitative assessment to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. We have one reporting unit for goodwill impairment testing purposes -- Community Banking. Prior to October 2016, we maintained two reporting units -- Community Banking and Insurance Services. The Insurance Services reporting unit consisted of the Company's wholly owned subsidiary Greenpoint, which was sold in October 2016. We performed our annual assessment of goodwill as of October 31, 2017, and concluded that our carrying value of goodwill was not impaired. Qualitative factors considered in the analysis included macroeconomic conditions, industry and market considerations, overall financial performance, changes in stock price, and our progress towards stated objectives as compared to prior years. An impairment charge to goodwill and other intangible assets may be required in the future if the Company's future earnings and cash flows decline or discount rates used in determining fair value increase. For additional information, see Note 9, "Goodwill and Other Intangible Assets," to the Consolidated Financial Statements in Item 8 of this report.

Income Taxes

The establishment of provisions for federal and state income taxes is a complex area of accounting that involves judgments and estimates in applying relevant tax statutes. We operate in many state tax jurisdictions, which requires the appropriate allocation of income and expense to each state based on a variety of apportionment or allocation bases. Audits by federal and state tax authorities may reveal liabilities that differ from our estimates and provisions. We continually evaluate our exposure to possible tax assessments arising from audits and record an estimate of possible exposure based on current facts and circumstances.

We measure deferred tax assets and liabilities using the enacted tax rates applicable in the periods we expect temporary differences to be realized or settled. As changes in tax laws and rates are enacted, we adjust deferred tax assets and liabilities through the provision for income taxes. When evidence indicates that it is more likely than not that some, or all, of the deferred tax asset is not recoverable, we may record a valuation allowance to reduce the carrying value of the asset. Increases or decreases in the valuation allowance result in increases or decreases to the provision for income taxes.

The Tax Cuts and Jobs Act ("Tax Reform Act") was enacted on December 22, 2017. Among other things, the new law establishes a new, flat corporate federal statutory income tax rate of 21%; eliminates the corporate alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxable year; limits the deduction for net interest expense incurred by U.S. corporations; allows businesses to immediately expense the cost of new investments in certain qualified depreciable assets for tax purposes; eliminates or reduces certain deductions related to meals and entertainment expenses; modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee;

and limits the deductibility of deposit insurance premiums. The Tax Reform Act also significantly changes U.S. tax law related to foreign operations, however, such changes do not currently impact us. As a result of the Tax Reform Act, we recognized income tax expense totaling $6.55 million related to the revaluation of our deferred tax balances, which includes provisional estimates primarily related to certain purchase accounting, indemnification asset, intangible, and depreciation items. We are still analyzing certain aspects of the Tax Reform Act and refining calculations, which could potentially affect the measurement of these balances. Based on current projections, we expect that our effective tax rate for 2018 will be approximately 22% to 23% under the new tax law; however, there can be no assurance to the actual amount as it is dependent upon the nature and amount of future income and expenses and transactions with discrete tax effects. For additional information, see Note 15, "Income Taxes," to the Consolidated Financial Statements in Item 8 of this report.

Performance Overview

Highlights of our results of operations in 2017, and financial condition as of December 31, 2017, include the following:

Pre-tax income increased $4.17 million, or 10.98%, to $42.11 million compared to the prior year.

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Net income decreased $3.64 million, or 14.49%, and diluted earnings per share decreased $0.19 to $1.26 compared to the prior year. Excluding the impact of the $6.55 million tax expense related to the Tax Reform Act, net income increased $2.91 million, or 11.59% to $28.04 million compared to the prior year.
The GAAP efficiency ratio improved to 60.44%, from 64.98%, and the non-GAAP efficiency ratio improved to 58.07%, from 61.75%, compared to the prior year.
Net interest margin increased 22 basis points to 4.23% and normalized net interest margin increased 18 basis points to 3.97% compared to the prior year.
Net charge-offs decreased $2.10 million, or 59.23%, to $1.44 million compared to the prior year.
Tangible book value per common share increased $0.75 to $14.64 compared to the prior year. The Company and the Bank both significantly exceed regulatory "well capitalized" targets as of December 31, 2017.

Results of Operations

Net Income

The following table presents the changes in net income and related information for the periods indicated:

	Year Ended December 31,			2017 Compared to 2016		2016 Compared to 2015	
	2017	2016	2015	Increase (Decrease)	% Change	Increase (Decrease)	% Change
(Amounts in thousands, except per share data)							
Net income	$21,485	$25,126	$24,540	$(3,641)	-14.49 %	$586	2.39 %
Net income available to common shareholders	21,485	25,126	24,435	(3,641)	-14.49 %	691	2.83 %
Basic earnings per common share	1.26	1.45	1.32	(0.19)	-13.10 %	0.13	9.85 %
Diluted earnings per common share	1.26	1.45	1.31	(0.19)	-13.10 %	0.14	10.69 %
Return on average assets	0.91 %	1.02 %	0.97 %	-0.11 %	-10.93 %	0.05 %	5.57 %
Return on average common equity	6.14 %	7.42 %	7.08 %	-1.28 %	-17.24 %	0.34 %	4.80 %

2017 Compared to 2016. Net income decreased in 2017 due to increases in income tax expense, driven by tax expense related to the Tax Reform Act, and the provision for loan losses and decrease in noninterest income. These changes were offset by an increase in net interest income and a decrease in noninterest expense.

2016 Compared to 2015. Net income increased in 2016 due to decreases in noninterest expense and in the provision for loan losses and an increase in net interest income. These changes were offset by a decrease in noninterest income and increase in income tax expense.

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Net Interest Income

Net interest income, our largest contributor to earnings, is analyzed on a fully taxable equivalent ("FTE") basis, a non-GAAP financial measure. For additional information, see "Non-GAAP Financial Measures" below. The following table presents the consolidated average balance sheets and net interest analysis on a FTE basis for the dates indicated:

(Amounts in thousands)	**Year Ended December 31, 2017** Average Balance	Interest[(1)]	Average Yield/ Rate[(1)]	**2016** Average Balance	Interest[(1)]	Average Yield/ Rate[(1)]	**2015** Average Balance	Interest[(1)]	Average Yield/ Rate[(1)]
Assets									
Earning assets									
Loans[(2)]	$1,837,092	$90,032	4.90 %	$1,793,618	$87,848	4.90 %	$1,680,021	$87,768	5.22 %
Securities available for sale	164,489	5,695	3.46 %	287,332	8,047	2.80 %	363,359	9,575	2.64 %
Securities held to maturity	32,954	487	1.48 %	71,069	757	1.07 %	70,987	770	1.08 %
Interest-bearing deposits	73,405	1,008	1.37 %	18,864	153	0.81 %	98,639	267	0.27 %
Total earning assets	2,107,940	$97,222	4.61 %	2,170,883	$96,805	4.46 %	2,213,006	$98,380	4.44 %
Other assets	262,381			284,575			307,928		
Total assets	$2,370,321			$2,455,458			$2,520,934		
Liabilities									
Interest-bearing deposits									
Demand deposits	$401,092	$412	0.10 %	$342,169	$250	0.07 %	$343,036	$203	0.06 %
Savings deposits	520,430	148	0.03 %	531,050	248	0.05 %	532,221	367	0.07 %
Time deposits	510,411	4,427	0.87 %	525,162	3,981	0.76 %	631,654	5,308	0.84 %
Total interest-bearing deposits	1,431,933	4,987	0.35 %	1,398,381	4,479	0.32 %	1,506,911	5,878	0.39 %
Borrowings									
Federal funds purchased	1	-	0.00 %	4,058	26	0.64 %	535	2	0.37 %
Retail repurchase agreements	47,716	32	0.07 %	68,701	49	0.07 %	71,262	68	0.10 %
Wholesale repurchase agreements	25,000	806	3.22 %	49,727	1,874	3.77 %	50,000	1,878	3.76 %
	55,502	2,265	4.08 %	116,602	3,416	2.93 %	89,400	3,523	3.94 %

FHLB advances and other borrowings									
Total borrowings	128,219	3,103	2.42 %	239,088	5,365	2.24 %	211,197	5,471	2.59 %
Total interest-bearing liabilities	1,560,152	8,090	0.52 %	1,637,469	9,844	0.60 %	1,718,108	11,349	0.66 %
Noninterest-bearing demand deposits	438,513			456,474			433,936		
Other liabilities	21,955			23,040			20,691		
Total liabilities	2,020,620			2,116,983			2,172,735		
Stockholders' equity	349,701			338,475			348,199		
Total liabilities and equity	$2,370,321			$2,455,458			$2,520,934		
Net interest income, FTE		$89,132			$86,961			$87,031	
Net interest rate spread, FTE			4.09 %			3.86 %			3.78 %
Net interest margin, FTE			4.23 %			4.01 %			3.93 %

(1) Fully taxable equivalent ("FTE") basis based on the federal statutory rate of 35%

(2) Nonaccrual loans are included in average balances; however, no related interest income is recognized during the period of nonaccrual.

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The following table presents the impact to net interest income on a FTE basis due to changes in volume (average volume times the prior year's average rate), rate (average rate times the prior year's average volume), and rate/volume (average volume times the change in average rate), for the periods indicated:

	Year Ended December 31, 2017 Compared to 2016 Dollar Increase (Decrease) due to				**Year Ended December 31, 2016 Compared to 2015 Dollar Increase (Decrease) due to**			
(Amounts in thousands)	**Volume**	**Rate**	**Rate/ Volume**	**Total**	**Volume**	**Rate**	**Rate/ Volume**	**Total**
Interest earned on[1]:								
Loans[2]	$2,130	$-	$ 54	$2,184	$5,930	$(5,376)	$(474)	$80
Securities available for sale	(3,440)	1,896	(808)	(2,352)	(2,007)	581	(102)	(1,528)
Securities held to maturity	(408)	291	(153)	(270)	1	(7)	(7)	(13)
Interest-bearing deposits with other banks	442	106	307	855	(215)	533	(432)	(114)
Total interest-earning assets	(1,276)	2,293	(600)	417	3,709	(4,269)	(1,015)	(1,575)
Interest paid on[1]:								
Demand deposits	41	103	18	162	(1)	34	14	47
Savings deposits	(5)	(106)	11	(100)	(1)	(106)	(12)	(119)
Time deposits	(112)	578	(20)	446	(895)	(505)	73	(1,327)
Federal funds purchased	(26)	(26)	26	(26)	13	1	10	24
Retail repurchase agreements	(15)	-	(2)	(17)	(3)	(21)	5	(19)
Wholesale repurchase agreements	(932)	(273)	137	(1,068)	(10)	5	1	(4)
FHLB advances and other Borrowings	(1,790)	1,341	(702)	(1,151)	1,072	(903)	(276)	(107)
Total interest-bearing liabilities	(2,839)	1,617	(532)	(1,754)	175	(1,495)	(185)	(1,505)
Change in net interest income, FTE	$1,563	$676	$ (68)	$2,171	$3,534	$(2,774)	$(830)	$(70)

(1) FTE basis based on the federal statutory rate of 35%

(2) Nonaccrual loans are included in average balances; however, no related interest income is recognized during the period of nonaccrual.

The following table presents the net interest analysis on a FTE basis excluding the impact of non-cash purchase accounting accretion from acquired loan portfolios for the periods indicated:

	Year Ended December 31, 2017		**2016**		**2015**	
(Amounts in thousands)	**Interest[1]**	**Average**	**Interest[1]**	**Average**	**Interest[1]**	**Average**

		Yield/ Rate[1]			Yield/ Rate[1]			Yield/ Rate[1]	
Earning assets									
Loans[2]	$90,032	4.90	%	$87,848	4.90	%	$87,768	5.22	%
Accretion income	7,863			7,690			11,258		
Less: cash accretion income	2,446			2,924			4,149		
Non-cash accretion income	5,417			4,766			7,109		
Loans, normalized[3]	84,615	4.61	%	83,082	4.63	%	80,659	4.80	%
Other earning assets	7,190	2.65	%	8,957	2.37	%	10,612	1.99	%
Total earning assets	91,805	4.36	%	92,039	4.24	%	91,271	4.12	%
Total interest-bearing liabilities	8,090	0.52	%	9,844	0.60	%	11,349	0.66	%
Net interest income, normalized[3]	$83,715			$82,195			$79,922		
Net interest rate spread, normalized[3]		3.84	%		3.64	%		3.46	%
Net interest margin, normalized[3]		3.97	%		3.79	%		3.61	%

(1) FTE basis based on the federal statutory rate of 35%

(2) Nonaccrual loans are included in average balances; however, no related interest income is recorded during the period of nonaccrual.

(3) Normalized totals are non-GAAP financial measures that exclude non-cash loan interest accretion related to PCI loans.

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2017 Compared to 2016. Net interest income comprised 76.87% of total net interest and noninterest income in 2017 compared to 75.82% in 2016. Net interest income on a GAAP basis increased $2.34 million, or 2.75%, and net interest income on a FTE basis increased $2.17 million, or 2.50%. Normalized net interest income on a FTE basis is a non-GAAP measure that excludes non-cash loan accretion income related to PCI loans. For additional information, see "Non-GAAP Financial Measures" below. Normalized net interest margin increased 18 basis points compared to an increase of 22 basis points on a FTE basis. Normalized net interest spread increased 20 basis points compared to an increase of 23 basis points on a FTE basis.

Average earning assets decreased $62.94 million, or 2.90%, primarily due to decreases in investment securities offset by an increase in interest-bearing deposits and loan growth. The normalized yield on earning assets increased 12 basis points compared to an increase of 15 basis points on a GAAP basis. Average loans increased $43.47 million, or 2.42%, and the average loan to deposit ratio increased to 98.22% from 96.70%. The normalized yield on loans decreased 2 basis points while remaining constant on a GAAP basis. Non-cash accretion income increased $651 thousand, or 13.66%.

Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, decreased $77.32 million, or 4.72%, primarily due to a decline in average borrowings. The yield on interest-bearing liabilities decreased 8 basis points, largely driven by a decrease in the average balance of borrowings. Average borrowings decreased $110.87 million, or 46.37%, largely due to a $61.10 million, or 52.40%, decrease in average FHLB advances and other borrowings, a $24.73 million, or 49.73%, decrease in average wholesale repurchase agreements, a $20.99 million, or 30.55%, decrease in average retail repurchase agreements, and a $4.06 million, or 99.98%, decrease in average federal funds purchased. Average interest-bearing deposits increased $33.55 million, or 2.40%, which was driven by a $58.92 million, or 17.22%, increase in average interest-bearing demand deposits offset by a $14.75 million, or 2.81%, decrease in average time deposits, and a $10.62 million, or 2.00%, decrease in average savings deposits, which include money market and savings accounts.

2016 Compared to 2015. Net interest income comprised 75.82% of total net interest and noninterest income in 2016 compared to 74.16% in 2015. Net interest income on a GAAP basis increased $127 thousand, or 0.15%, and net interest income on a FTE basis decreased $70 thousand, or 0.08%. Normalized net interest income on a FTE basis is a non-GAAP measure that excludes non-cash loan accretion income related to PCI loans. For additional information, see "Non-GAAP Financial Measures" below. Normalized net interest margin increased 18 basis points compared to an increase of 8 basis points on a FTE basis. The normalized and FTE net interest spread increased 18 basis points.

Average earning assets decreased $42.12 million, or 1.90%, primarily due to decreases in securities available for sale and interest-bearing deposits offset by loan growth. The normalized yield on earning assets increased 12 basis points compared to an increase of 2 basis points on a GAAP basis. Average loans increased $113.60 million, or 6.76%, and the average loan to deposit ratio increased to 96.70% from 86.56%. The normalized yield on loans decreased 17 basis points compared to a decrease of 32 basis points on a GAAP basis. Non-cash accretion income decreased $2.34 million, or 32.96%, as the effect of accretion income continued to decline from acquired portfolio attrition.

Average interest-bearing liabilities, which consist of interest-bearing deposits and borrowings, decreased $80.64 million, or 4.69%, primarily due to a decline in average interest-bearing time deposit balances. The yield on interest-bearing liabilities decreased 6 basis points, which was comprised of a 7 basis point decrease in the rate on interest-bearing deposits and a 1 basis point increase in the rate on borrowings. Average interest-bearing deposits decreased $108.53 million, or 7.20%, which was driven by a $106.49 million, or 16.86%, decrease in average time deposits, a $1.17 million, or 0.22%, decrease in savings deposits, which include money market and savings accounts, and an $867 thousand, or 0.25%, decrease in interest-bearing demand deposits. Average borrowings increased $27.89 million, or 13.21%, largely due to a $27.20 million, or 30.43%, increase in average FHLB advances and other borrowings.

Provision for Loan Losses

2017 Compared to 2016. The provision charged to operations increased $1.52 million to $2.77 million, which included a $1.49 million increase in the non-PCI provision to $2.78 million and a $30 thousand increase in the PCI provision to a recovery of $12 thousand.

2016 Compared to 2015. The provision charged to operations decreased $936 thousand to $1.26 million, which included an $870 thousand decrease in the non-PCI provision to $1.30 million and a $66 thousand decrease in the PCI provision to a recovery of $41 thousand. The provision charged to operations included a $1 thousand benefit attributed to the FDIC indemnification asset to reflect the indemnified portion of the post-acquisition exposure. The reduction in the non-PCI provision was partially due to the reversal of loan loss reserves totaling $1.35 million attributed to loans divested in the First Bank transaction.

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Noninterest Income

The following table presents the components of, and changes in, noninterest income for the periods indicated:

	Year Ended December 31, 2017	2016	2015	2017 Compared to 2016 Increase (Decrease)	% Change	2016 Compared to 2015 Increase (Decrease)	% Change
(Amounts in thousands)							
Wealth management	$3,150	$2,828	$2,975	$322	11.39 %	$(147)	-4.94 %
Service charges on deposits	13,803	13,588	13,717	215	1.58 %	(129)	-0.94 %
Other service charges and fees	8,624	8,102	8,045	522	6.44 %	57	0.71 %
Insurance commissions	1,347	5,442	6,899	(4,095)	-75.25 %	(1,457)	-21.12 %
Net impairment loss	-	(4,646)	-	4,646	-100.00%	(4,646)	-
Net (loss) gain on sale of securities	(661)	335	144	(996)	-297.31%	191	132.64 %
Net FDIC indemnification asset amortization	(3,517)	(5,474)	(6,379)	1,957	-35.75 %	905	-14.19 %
Net gain on divestitures	-	3,682	-	(3,682)	-100.00%	3,682	-
Other operating income	3,502	3,209	4,129	293	9.13 %	(920)	-22.28 %
Total noninterest income	$26,248	$27,066	$29,530	$(818)	-3.02 %	$(2,464)	-8.34 %

2017 Compared to 2016. Noninterest income comprised 23.13% of total net interest and noninterest income in 2017 compared to 24.18% in 2016. Noninterest income decreased $818 thousand, or 3.02%, primarily due to a decrease in insurance commissions and the associated net gain related to the Greenpoint divestiture in the fourth quarter of 2016 and divestiture of six bank branches to First Bank in the third quarter of 2016. The decrease was largely offset by the absence of net impairment losses and the decrease in net negative amortization related to the FDIC indemnification asset as loss share coverage on commercial loans expired on June 30, 2017. We recognized a net loss of $661 thousand on the sale of securities related primarily to certain single issue trust preferred securities. See Note 3, “Investment Securities,” to the Consolidated Financial Statements in Item 1 of this report. Excluding the impact from impairment losses, sales of securities and branches, net FDIC indemnification asset amortization, the net gain on divestitures, and bank owned life insurance proceeds, noninterest income decreased $2.76 million, or 8.44%, to $29.97 million in 2017, from $32.73 million in 2016. The decrease was primarily due to the $4.10 million decrease in insurance commissions resulting from the Greenpoint divestiture offset by increases in wealth management income, service charges and fees, and other operating income.

2016 Compared to 2015. Noninterest income comprised 24.18% of total net interest and noninterest income in 2016 compared to 25.84% in 2015. Noninterest income decreased $2.46 million, or 8.34%, in 2016 primarily due to net impairment losses offset by a net gain on divestitures and a decrease in insurance commissions. We realized net impairment losses of $4.64 million on certain debt securities and $11 thousand on certain equity securities. We realized a net gain of $3.68 million on the divestiture of Greenpoint and six bank branches. Insurance commissions decreased largely due to the Greenpoint divestiture. Other operating income decreased primarily due to the absence of a $1.14 million net death benefit from the maturity of a life insurance policy recognized in 2015 offset by a $381 thousand gain on the sale of closed branches and $474 thousand in legal settlements. Net negative amortization related to the FDIC indemnification asset decreased as the expiration of the loss share agreement for commercial loans approaches. We recognized a net gain of $335 thousand on the sale of securities related primarily to certain Agency mortgage-backed securities. Excluding the impact from impairment losses, sales of securities and branches, net FDIC indemnification asset amortization, the net gain on divestitures, and net death benefits, noninterest income decreased $1.89 million, or 5.47%, to $32.73 million in 2016 from $34.62 million in 2015.

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Noninterest Expense

The following table presents the components of, and changes in, noninterest expense for the periods indicated:

	Year Ended December 31,			2017 Compared to 2016		2016 Compared to 2015	
	2017	2016	2015	Increase (Decrease)	% Change	Increase (Decrease)	% Change
(Amounts in thousands)							
Salaries and employee benefits	$36,317	$39,912	$39,625	$(3,595)	-9.01 %	$287	0.72 %
Occupancy expense	4,775	5,297	5,817	(522)	-9.85 %	(520)	-8.94 %
Furniture and equipment expense	4,425	4,341	5,199	84	1.94 %	(858)	-16.50 %
Amortization of intangibles	1,056	1,136	1,118	(80)	-7.04 %	18	1.61 %
FDIC premiums and assessments	910	1,383	1,513	(473)	-34.20 %	(130)	-8.59 %
FHLB debt prepayment fees	-	-	1,702	-	-	(1,702)	-100.00 %
Merger, acquisition, and divestiture expense	-	730	86	(730)	-100.00 %	644	748.84 %
Other operating expense	21,099	19,947	21,111	1,152	5.78 %	(1,164)	-5.51 %
Total noninterest expense	$68,582	$72,746	$76,171	$(4,164)	-5.72 %	$(3,425)	-4.50 %

2017 Compared to 2016. Noninterest expense decreased $4.16 million, or 5.72%, in 2017 compared to 2016, which was largely due to a decrease in salaries and employee benefits coupled with the absence of merger, acquisition, and divestiture expense and decreases in occupancy, furniture, and equipment expense, FDIC premiums and assessments, and intangible amortization. Salaries and employee benefits decreased as full-time equivalent employees, calculated using the number of hours worked, decreased to 562 as of December 31, 2017, from 580 as of December 31, 2016. The increase in other operating expense included a $759 thousand increase in legal fees and write-downs on certain long-term investments in land and buildings totaling $552 thousand, which were offset by a $218 thousand decrease in the net loss on sales and expenses related to other real estate owned ("OREO") to $1.20 million from $1.42 million in 2016.

2016 Compared to 2015. Noninterest expense decreased $3.43 million, or 4.50%, in 2016 compared to 2015, which was largely due to the absence of FHLB prepayment penalties and a decrease in operating expenses. The decrease in other operating expense was primarily due to a $1.02 million decrease in the net loss on sales and expenses related to OREO to $1.42 million from $2.44 million in 2015. The decrease was offset by a $535 thousand increase in consulting fees and a $425 thousand increase in legal fees. We incurred expenses totaling $730 thousand related to the First Bank branch exchange and divestiture of Greenpoint. Occupancy, furniture, and equipment expense decreased $1.38 million, or 12.51%, due to branch closures and divestitures. Full-time equivalent employees decreased to 580 as of December 31, 2016, from 673 as of December 31, 2015, primarily due to personnel restructuring as a result of the First Bank and Greenpoint transactions.

Income Tax Expense

2017 Compared to 2016. Income tax expense increased $7.81 million, or 60.92%, and the effective tax rate increased to 48.98% compared to 33.78% in the prior year. The increase was largely attributed to tax expense of $6.55 million related to the revaluation of our net deferred tax asset in accordance with the Tax Reform Act. Excluding the impact of the revaluation, income tax expense increased $1.26 million, or 9.81%, and the effective rate decreased 36 basis points to 33.42% largely from a decrease in taxable revenues as a percent of operating earnings. For additional information, see Note 15, “Income Taxes,” to the Consolidated Financial Statements in Item 8 of this report.

2016 Compared to 2015. Income tax expense increased $1.44 million, or 12.64%, and the effective tax rate increased 210 basis points to 33.78%. The increase in the effective tax rate was largely due to an increase in taxable revenues as a percent of operating earnings and non-deductible goodwill related to the Greenpoint divestiture.

Non-GAAP Financial Measures

In addition to financial statements prepared in accordance with GAAP, we use certain non-GAAP financial measures that management believes provide investors with important information useful in understanding our operational performance and comparing our financial measures with other financial institutions. The non-GAAP financial measures presented in this report include net interest income on a FTE basis and normalized net interest income on a FTE basis. While we believe these non-GAAP financial measures enhance understanding of our business and performance, they are supplemental and not a substitute for, or more important than, financial measures prepared on a GAAP basis. Our non-GAAP financial measures may not be comparable to those reported by other financial institutions. The reconciliations of these measures to GAAP measures are presented below.

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We believe FTE basis is the preferred industry measurement of net interest income and provides better comparability between taxable and tax exempt amounts. We use this non-GAAP financial measure to monitor net interest income performance and to manage the composition of our balance sheet. The FTE basis adjusts for the tax benefits of income from certain tax exempt loans and investments using the federal statutory rate of 35%. Normalized net interest income on a FTE basis is a non-GAAP measure that excludes non-cash loan accretion income related to PCI loans.

The following table reconciles net interest income and margin, as presented in our consolidated statements of income, to net interest income on a FTE basis for the periods indicated:

	Year Ended December 31,		
	2017	**2016**	**2015**
(Amounts in thousands)			
Net interest income, GAAP	$87,218	$84,880	$84,753
FTE adjustment[1]	1,914	2,081	2,278
Net interest income, FTE	89,132	86,961	87,031
Less: non-cash accretion income[2]	5,417	4,766	7,109
Net interest income, normalized	$83,715	$82,195	$79,922
Net interest margin, GAAP	4.14 %	3.91 %	3.83 %
FTE adjustment[1]	0.09 %	0.10 %	0.10 %
Net interest margin, FTE	4.23 %	4.01 %	3.93 %
Less: non-cash accretion income[2]	0.26 %	0.22 %	0.32 %
Net interest margin, normalized	3.97 %	3.79 %	3.61 %

(1) FTE basis based on the federal statutory rate of 35%
(2) Includes non-cash purchase accounting accretion income from acquired loan portfolios

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We believe the efficiency ratio provides investors with important information about our operating expense control and efficiency of operations. Management also believes this non-GAAP measure focuses attention on our core operating performance over time. The following table reconciles the GAAP-based efficiency ratio to the non-GAAP efficiency ratio for the periods indicated:

	Year Ended December 31,		
(Amounts in thousands)	**2017**	**2016**	**2015**
GAAP efficiency ratio			
Noninterest expense	$68,582	$72,746	$76,171
Net interest income	87,218	84,880	84,753
Noninterest income	26,248	27,066	29,530
Net interest income plus noninterest income	113,466	111,946	114,283
GAAP efficiency ratio	60.44 %	64.98 %	66.65 %
Non-GAAP efficiency ratio			
Noninterest expense, GAAP	$68,582	$72,746	$76,171
Non-GAAP adjustments			
Merger, acquisition, and divestiture expense	-	(730)	(86)
FHLB debt prepayment fees	-	-	(1,702)
OREO expense and net loss	(1,202)	(1,420)	(2,438)
Other non-core items	(391)	(364)	(259)
Total non-GAAP adjustments	(1,593)	(2,514)	(4,485)
Adjusted noninterest expense	66,989	70,232	71,686
Net interest income plus noninterest income, GAAP	113,466	111,946	114,283
Non-GAAP adjustments			
Tax equivalency adjustment	1,914	2,081	2,950
Net impairment losses	-	4,646	-
Net loss (gain) on sale of securities	661	(335)	(144)
Net gain on divestitures	-	(3,682)	-
Other non-core items	(689)	(918)	(1,263)
Total non-GAAP adjustments	1,886	1,792	1,543
Adjusted net interest income plus noninterest income	115,352	113,738	115,826
Non-GAAP efficiency ratio[(1)]	58.07 %	61.75 %	61.89 %

(1) A non-GAAP financial measure computed by dividing adjusted noninterest expense by the sum of tax equivalent net interest income and adjusted noninterest income

Financial Condition

Total assets as of December 31, 2017, increased $2.06 million, or 0.09%, to $2.39 billion from $2.39 billion as of December 31, 2016. Total liabilities as of December 31, 2017, decreased $9.60 million, or 0.47%, to $2.04 billion from $2.05 billion as of December 31, 2016.

Investment Securities

Our investment securities are used to generate interest income through the employment of excess funds, to provide liquidity, to fund loan demand or deposit liquidation, and to pledge as collateral where required. The composition of our investment portfolio changes from time to time as we consider our liquidity needs, interest rate expectations, asset/liability management strategies, and capital requirements.

Available-for-sale securities as of December 31, 2017, remained relatively constant compared to December 31, 2016, with a change in composition resulting from the purchase of U.S. Treasury securities offset by the maturity and sale of municipal, single-issue trust preferred, and mortgage-backed Agency securities. Held-to-maturity securities as of December 31, 2017, decreased $21.98 million, or 46.64%, compared to December 31, 2016, primarily due to the maturity of U.S. Agency securities.

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The following table presents the amortized cost and fair value of investment securities as of the dates indicated:

	December 31, 2017		2016		2015	
(Amounts in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for Sale						
U.S. Agency securities	$11,289	$11,296	$1,342	$1,345	$31,414	$30,702
U.S. Treasury securities	19,987	19,971	-	-	-	-
Municipal securities	101,552	103,648	111,659	113,331	124,880	128,678
Single issue trust preferred securites	9,367	8,884	22,104	19,939	55,882	47,832
Corporate securities	-	-	-	-	70,571	70,333
Certificates of deposit	-	-	-	-	5,000	5,000
Mortgage-backed Agency securities	22,095	21,726	31,290	30,891	84,576	83,556
Equity securities	55	55	55	73	66	72
Total securities available for sale	$164,345	$165,580	$166,450	$165,579	$372,389	$366,173
Fair value to amortized cost		100.75 %		99.48 %		98.33 %
Held to Maturity						
U.S. Agency securities	$17,937	$17,888	$36,741	$36,865	$61,863	$61,832
Municipal securities	-	-	-	-	190	193
Corporate securities	7,212	7,196	10,392	10,401	10,488	10,465
Total securities held to maturity	$25,149	$25,084	$47,133	$47,266	$72,541	$72,490
Fair value to amortized cost		99.74 %		100.28 %		99.93 %

The following table provides information about our investment portfolio as of the dates indicated:

	December 31, 2017			2016		
(Amounts in years)	Available for Sale	Held to Maturity	Total	Available for Sale	Held to Maturity	Total
Average life	5.44	1.11	4.87	7.75	1.30	6.32
Average duration	4.74	1.09	4.26	6.66	1.26	5.47

There were no holdings of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of our total consolidated shareholders’ equity as of December 31, 2017 or 2016.

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The following tables present the amortized cost, fair value, and weighted-average yield of available-for-sale and held-to-maturity securities, by contractual maturity, as of December 31, 2017. Actual maturities could differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

(Amounts in thousands)	**Available-for-Sale Securities** U.S. Agency Securities	U.S. Treasury Securities	Municipal Securities	Corporate Notes	Total	Tax Equivalent Purchase Yield[1]
Amortized cost maturity:						
One year or less	$10,065	$19,987	$-	$ -	$30,052	1.17 %
After one year through five years	-	-	7,193	-	7,193	4.57 %
After five years through ten years	1,224	-	90,062	9,367	100,653	4.15 %
After ten years	-	-	4,297	-	4,297	4.43 %
Amortized cost	$11,289	$19,987	$101,552	$ 9,367	142,195	
Mortgage-backed securities					22,095	2.18 %
Equity securities					55	0.00 %
Total amortized cost					$164,345	
Tax equivalent purchase yield[1]	1.46 %	1.13 %	4.39 %	2.08 %	3.55 %	
Average contractual maturity (in years)	1.37	0.25	7.48	9.08	6.09	
Fair value maturity:						
One year or less	$10,055	$19,971	$-	$ -	$30,026	
After one year through five years	-	-	7,308	-	7,308	
After five years through ten years	1,241	-	91,886	8,884	102,011	
After ten years	-	-	4,454	-	4,454	
Fair value	$11,296	$19,971	$103,648	$ 8,884	143,799	
Mortgage-backed securities					21,726	
Equity securities					55	
Total fair value					$165,580	

(1) FTE basis based on the federal statutory rate of 35%

(Amounts in thousands)	**Held-to-Maturity Securities** U.S. Agency Securities	Corporate Notes	Total	Tax Equivalent Purchase Yield[1]
Amortized cost maturity:				
One year or less	$-	$ -	$-	0.00 %
After one year through five years	17,937	7,212	25,149	1.67 %

After five years through ten years	-	-	-	0.00	%
After ten years	-	-	-	0.00	%
Total amortized cost	$17,937	$ 7,212	$25,149		
Tax equivalent purchase yield[1]	1.59 %	1.84 %	1.67 %		
Average contractual maturity (in years)	1.14	1.06	1.11		
Fair value maturity:					
One year or less	$-	$ -	$-		
After one year through five years	17,888	7,196	25,084		
After five years through ten years	-	-	-		
After ten years	-	-	-		
Total fair value	$17,888	$ 7,196	$25,084		

(1) FTE basis based on the federal statutory rate of 35%

Investment securities are reviewed quarterly for possible other-than-temporary impairment ("OTTI") charges. We recognized no OTTI charges in earnings associated with debt securities in 2017 or 2015. We recognized OTTI charges in earnings associated with debt securities of $4.64 million in 2016 due to our change in intent to hold certain trust preferred securities in our portfolio to recovery. These specific securities were sold to reduce credit concentrations with two issuers, which increased cash reserves and reduced exposure to the financial industry. We recognized no OTTI charges in earnings associated with equity securities in 2017 or 2015. We recognized OTTI charges in earnings associated with certain equity securities of $11 thousand in 2016. For additional information, see "Investment Securities" in the "Critical Accounting Estimates" section above and Note 3, "Investment Securities," to the Consolidated Financial Statements in Item 8 of this report.

Loans Held for Investment

Loans held for investment, our largest component of interest income, are grouped into commercial, consumer real estate, and consumer and other loan segments. Each segment is divided into various loan classes based on collateral or purpose. Certain loans acquired in FDIC-assisted transactions are covered under loss share agreements ("covered loans"). The general characteristics of each loan segment are as follows:

Commercial loans – This segment consists of loans to small and mid-size industrial, commercial, and service companies that include, but are not limited to, natural gas producers, retail merchants, and wholesale merchants. Commercial real estate projects represent a variety of sectors of the commercial real estate market, including single family and apartment lessors, commercial real estate lessors, and hotel/motel operators. Commercial loan underwriting guidelines require that comprehensive reviews and independent evaluations be performed on credits exceeding predefined size limits. Updates to these loan reviews are done periodically or annually depending on the size of the loan relationship.

Consumer real estate loans – This segment consists of loans to individuals within our market footprint for home equity loans and lines of credit and for the purchase or construction of owner occupied homes. Residential real estate loan underwriting guidelines require that borrowers meet certain credit, income, and collateral standards at origination.

Consumer and other loans – This segment consists of loans to individuals within our market footprint that include, but are not limited to, personal lines of credit, credit cards, and the purchase of automobiles, boats, mobile homes, and other consumer goods. Consumer loan underwriting guidelines require that borrowers meet certain credit, income, and collateral standards at origination.

Total loans held for investment, net of unearned income, as of December 31, 2017, decreased $35.76 million, or 1.93%, compared to December 31, 2016, primarily due to a $29.05 million, or 50.96%, decrease in covered loans due to the expiration of the commercial loss share agreement on June 30, 2017, and continued loan runoff in the remaining portfolio. Non-covered loans decreased $6.72 million, or 0.37%, which was driven by declines in residential real estate. We had no foreign loans or loan concentrations to any single borrower or industry, which are not otherwise disclosed as a category of loans, that represented 10% or more of outstanding loans, as of December 31, 2017 or 2016. For additional information, see Note 4, "Loans," to the Consolidated Financial Statements in Item 8 of this report.

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The following table presents loans, net of unearned income and by loan class, as of the dates indicated:

	December 31,				
(Amounts in thousands)	**2017**	**2016**	**2015**	**2014**	**2013**
Non-covered loans held for investment					
Commercial loans					
Construction, development, and other land	$60,017	$56,948	$48,896	$41,271	$35,255
Commercial and industrial	92,188	92,204	88,903	83,099	95,455
Multi-family residential	125,202	134,228	95,026	97,480	70,197
Single family non-owner occupied	141,670	142,965	149,351	135,171	135,559
Non-farm, non-residential	616,633	598,674	485,460	473,906	475,911
Agricultural	7,035	6,003	2,911	1,599	2,324
Farmland	25,649	31,729	27,540	29,517	32,614
Total commercial loans	1,068,394	1,062,751	898,087	862,043	847,315
Consumer real estate loans					
Home equity lines	103,205	106,361	107,367	110,957	111,770
Single family owner occupied	502,686	500,891	495,209	485,475	496,012
Owner occupied construction	39,178	44,535	43,505	32,799	28,703
Total consumer real estate loans	645,069	651,787	646,081	629,231	636,485
Consumer and other loans					
Consumer loans	70,772	77,445	72,000	69,347	71,313
Other	5,001	3,971	7,338	6,555	3,926
Total consumer and other loans	75,773	81,416	79,338	75,902	75,239
Total non-covered loans	1,789,236	1,795,954	1,623,506	1,567,176	1,559,039
Total covered loans	27,948	56,994	83,035	122,240	151,682
Total loans held for investment, net of unearned income	1,817,184	1,852,948	1,706,541	1,689,416	1,710,721
Less: allowance for loan losses	19,276	17,948	20,233	20,227	24,077
Total loans held for investment, net of unearned income and allowance	$1,797,908	$1,835,000	$1,686,308	$1,669,189	$1,686,644
Loans held for sale	$-	$-	$-	$1,792	$883

The following table presents covered loans, by loan class, as of the dates indicated:

	December 31,				
(Amounts in thousands)	**2017**	**2016**	**2015**	**2014**	**2013**
Commercial loans					
Construction, development, and other land	$39	$4,570	$6,303	$13,100	$15,865
Commercial and industrial	-	895	1,170	2,662	3,325
Multi-family residential	-	8	640	1,584	1,933
Single family non-owner occupied	284	962	2,674	5,918	7,449
Non-farm, non-residential	9	7,512	14,065	25,317	34,646

Agricultural	-	25	34	43	164
Farmland	-	397	643	716	873
Total commercial loans	332	14,369	25,529	49,340	64,255
Consumer real estate loans					