Section 1: 10-Q (QUARTERLY REPORT)

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from _____ to _____.

Commission file number 001-16767

Western New England Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts	**73-1627673**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

141 Elm Street, Westfield, Massachusetts 01086
(Address of principal executive offices)
(Zip Code)

(413) 568-1911
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of 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 such files.) Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 (Check one):

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

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

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

At November 2, 2018, the registrant had 29,315,837 shares of common stock, $0.01 par value, issued and outstanding.

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FORWARD–LOOKING STATEMENTS

We may, from time to time, make written or oral “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission (the “SEC”), our reports to shareholders and in other communications by us. This Quarterly Report on Form 10-Q contains “forward-looking statements,” which may be identified by the use of such words as “believe,” “expect,” “anticipate,” “should,” “would,” “plan,” “estimate,” “potential” and other similar expressions. Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to:

- changes in the interest rate environment that reduce margins;
- the effect on our operations of governmental legislation and regulation, including changes in accounting regulation or standards, the nature and timing of the adoption and effectiveness of new requirements under the Dodd-Frank Act Wall Street Reform and Consumer Protection Act of 2010, Basel guidelines, capital requirements and other applicable laws and regulations;
- the highly competitive industry and market area in which we operate;
- general economic conditions, either nationally or regionally, resulting in, among other things, a deterioration in credit quality;
- changes in business conditions and inflation;
- changes in credit market conditions;
- the inability to realize expected cost savings or achieve other anticipated benefits in connection with business combinations and other acquisitions;
- changes in the securities markets which affect investment management revenues;
- increases in Federal Deposit Insurance Corporation deposit insurance premiums and assessments;
- changes in technology used in the banking business;
- the soundness of other financial services institutions which may adversely affect our credit risk;
- certain of our intangible assets may become impaired in the future;
- our controls and procedures may fail or be circumvented;
- new line of business or new products and services, which may subject us to additional risks;
- changes in key management personnel which may adversely impact our operations;
- severe weather, natural disasters, acts of war or terrorism and other external events which could significantly impact our business; and
- other factors detailed from time to time in our SEC filings.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, except to the extent required by law.

PART I – FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS.
WESTERN NEW ENGLAND BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS - UNAUDITED
(Dollars in thousands, except share data)

	September 30, 2018	December 31, 2017
ASSETS		
CASH AND DUE FROM BANKS	$ 27,923	$ 21,607
FEDERAL FUNDS SOLD	6,259	322
INTEREST-BEARING DEPOSITS AND OTHER SHORT-TERM INVESTMENTS	27,817	5,203
CASH AND CASH EQUIVALENTS	61,999	27,132
SECURITIES AVAILABLE-FOR-SALE – AT FAIR VALUE	252,984	288,416
MARKETABLE EQUITY SECURITIES – AT FAIR VALUE	6,319	—
FEDERAL HOME LOAN BANK OF BOSTON AND OTHER RESTRICTED STOCK - AT COST	15,480	15,553
LOANS - Net of allowance for loan losses of $12,235 and $10,831 at September 30, 2018 and December 31, 2017, respectively	1,680,333	1,619,850
PREMISES AND EQUIPMENT, Net	24,460	23,500
ACCRUED INTEREST RECEIVABLE	5,831	5,946
BANK-OWNED LIFE INSURANCE	68,801	68,762
DEFERRED TAX ASSET, Net	10,557	8,784
GOODWILL	12,487	12,487
CORE DEPOSIT INTANGIBLE	3,781	4,063
OTHER ASSETS	7,493	8,577
TOTAL ASSETS	$ 2,150,525	$ 2,083,070
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
DEPOSITS :		
Non-interest-bearing	$ 357,845	$ 311,851
Interest-bearing	1,251,174	1,194,231
Total deposits	1,609,019	1,506,082
SHORT-TERM BORROWINGS	55,000	144,650
LONG-TERM DEBT	224,306	164,786
OTHER LIABILITIES	20,915	20,271
TOTAL LIABILITIES	1,909,240	1,835,789
SHAREHOLDERS' EQUITY:		
Preferred stock - $0.01 par value, 5,000,000 shares authorized, none outstanding at September 30, 2018 and December 31, 2017	—	—
Common stock - $0.01 par value, 75,000,000 shares authorized, 29,453,808 shares issued and outstanding at September 30, 2018; 30,487,309 shares issued and outstanding at December 31, 2017	295	305
Additional paid-in capital	192,581	203,527
Unearned compensation – ESOP	(5,325)	(5,786)
Unearned compensation – Equity Incentive Plan	(1,010)	(791)
Retained earnings	71,402	62,578
Accumulated other comprehensive loss	(16,658)	(12,552)
TOTAL SHAREHOLDERS' EQUITY:	241,285	247,281
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 2,150,525	$ 2,083,070

See accompanying notes to unaudited consolidated financial statements.

WESTERN NEW ENGLAND BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF NET INCOME – UNAUDITED
(Dollars in thousands, except per share data)

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
INTEREST AND DIVIDEND INCOME:				
Residential and commercial real estate loans	$ 14,507	$ 13,474	$ 42,850	$ 40,042
Commercial and industrial loans	2,982	2,883	9,573	8,180
Consumer loans	88	88	261	260
Debt securities, taxable	1,709	1,828	5,227	5,529
Debt securities, tax-exempt	19	25	64	81
Equity securities	38	35	112	105
Other investments	228	172	631	501
Short-term investments	34	11	83	103
Total interest and dividend income	19,605	18,516	58,801	54,801
INTEREST EXPENSE:				
Deposits	3,094	2,111	8,167	6,180
Long-term debt	1,193	534	3,178	1,633
Short-term borrowings	713	1,075	2,264	2,946
Total interest expense	5,000	3,720	13,609	10,759
Net interest and dividend income	14,605	14,796	45,192	44,042
PROVISION FOR LOAN LOSSES	350	200	1,600	850
Net interest and dividend income after provision for loan losses	14,255	14,596	43,592	43,192
NON-INTEREST INCOME (LOSS):				
Service charges and fees	1,891	1,714	5,167	4,789
Income from bank-owned life insurance	448	450	1,374	1,369
Bank-owned life insurance death benefit	—	—	715	—
Gain (loss) on securities, net	—	70	(250)	52
Unrealized losses on marketable equity securities, net	(43)	—	(190)	—
Gain on sale of other real estate owned	—	67	48	67
Other income	—	111	131	227
Total non-interest income	2,296	2,412	6,995	6,504
NON-INTEREST EXPENSE:				
Salaries and employee benefits	6,451	6,490	19,548	18,954
Occupancy	952	891	2,979	2,815
Furniture and equipment	400	410	1,149	1,149
Data processing	642	680	1,957	1,740
Professional fees	767	642	2,107	1,919
FDIC insurance assessment	158	163	463	466
Merger related expenses	—	—	—	526
Advertising	351	328	1,053	961
Other expenses	1,851	1,552	5,288	4,892
Total non-interest expense	11,572	11,156	34,544	33,422
INCOME BEFORE INCOME TAXES	4,979	5,852	16,043	16,274
INCOME TAX PROVISION	1,070	2,037	3,476	3,600
NET INCOME	$ 3,909	$ 3,815	$ 12,567	$ 12,674
EARNINGS PER COMMON SHARE:				
Basic earnings per share	$ 0.14	$ 0.13	$ 0.43	$ 0.42
Weighted average shares outstanding	28,789,132	30,103,095	29,100,735	29,895,621
Diluted earnings per share	$ 0.14	$ 0.13	$ 0.43	$ 0.42
Weighted average diluted shares outstanding	28,937,038	30,219,083	29,242,862	30,074,361

See accompanying notes to unaudited consolidated financial statements.

WESTERN NEW ENGLAND BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – UNAUDITED
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Net income	$ 3,909	$ 3,815	$ 12,567	$ 12,674
Other comprehensive income (loss):				
Unrealized (losses) gains on securities:				
Unrealized holding (losses) gains on available-for-sale securities	(1,635)	381	(8,059)	2,133
Reclassification adjustment for (gain) loss realized in income(1)	—	(70)	250	(52)
Unrealized (losses) gains on securities	(1,635)	311	(7,809)	2,081
Tax effect	404	(100)	1,733	(627)
Net-of-tax amount	(1,231)	211	(6,076)	1,454
Cash flow hedges:				
Change in fair value of derivatives used for cash flow hedges	168	(14)	1,086	(307)
Reclassification adjustment for loss realized in interest expense(2)	82	228	355	751
Reclassification adjustment for termination fee realized in interest expense(3)	269	269	799	799
Unrealized gains on cash flow hedges	519	483	2,240	1,243
Tax effect	(145)	(133)	(629)	32
Net-of-tax amount	374	350	1,611	1,275
Defined benefit pension plan:				
Amortization of defined benefit plan actuarial loss(4)	56	51	170	153
Tax effect	(16)	28	(48)	312
Net-of-tax amount	40	79	122	465
Other comprehensive (loss) income	(817)	640	(4,343)	3,194
Comprehensive income	$ 3,092	$ 4,455	$ 8,224	$ 15,868

(1) Realized gains and losses on available-for-sale securities are recognized as a component of non-interest income. The tax effects applicable to net realized gains were $29,000 for the three months ended September 30, 2017. The tax effects applicable to net realized (loss) gains were $(70,000) and $21,000 for the nine months ended September 30, 2018 and 2017, respectively.

(2) Loss realized in interest expense on derivative instruments is recognized as a component of interest expense on short-term borrowings. Income tax effects associated with the reclassification adjustments were $23,000 and $93,000 for the three months ended September 30, 2018 and 2017, respectively. Income tax effects associated with the reclassification adjustments were $100,000 and $307,000 for the nine months ended September 30, 2018 and 2017, respectively.

(3) Loss realized in interest expense on derivative instruments is recognized as a component of interest expense on short-term borrowings. Income tax effects associated with the reclassification adjustments were $76,000 and $110,000 for the three months ended September 30, 2018 and 2017, respectively. Income tax effects associated with the reclassification adjustments were $225,000 and $326,000 for the nine months ended September 30, 2018 and 2017, respectively.

(4) Amounts represent the reclassification of defined benefit plan amortization and have been recognized as a component of non-interest expense. Income tax effects associated with the reclassification adjustments were $16,000 and $21,000 for the three months ended September 30, 2018 and 2017, respectively. Income tax effects associated with the reclassification adjustments were $48,000 and $63,000 for the nine months ended September 30, 2018 and 2017, respectively.

See accompanying notes to unaudited consolidated financial statements.

WESTERN NEW ENGLAND BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY - UNAUDITED
NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017
(Dollars in thousands, except share data)

	Common Stock		Additional Paid-in Capital	Unearned Compensation - ESOP	Unearned Compensation - Equity Incentive Plan	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Par Value						
BALANCE AT DECEMBER 31, 2016	30,380,231	$ 304	$ 205,996	$ (6,418)	$ (536)	$ 51,711	$ (12,661)	$ 238,396
Comprehensive income	—	—	—	—	—	12,674	3,194	15,868
Common stock held by ESOP committed to be released (93,679 shares)	—	—	226	472	—	—	—	698
Share-based compensation - equity incentive plan	—	—	—	—	490	—	—	490
Common stock repurchased	(574,309)	(5)	(5,667)	—	—	—	—	(5,672)
Issuance of common stock in connection with stock option exercises	921,849	9	5,456	—	—	—	—	5,465
Issuance of common stock in connection with equity incentive plan	89,042	1	903	—	(904)	—	—	—
Cash dividends declared and paid ($0.09 per share)	—	—	—	—	—	(2,690)	—	(2,690)
BALANCE AT SEPTEMBER 30, 2017	30,816,813	$ 309	$ 206,914	$ (5,946)	$ (950)	$ 61,695	$ (9,467)	$ 252,555
BALANCE AT DECEMBER 31, 2017	30,487,309	$ 305	$ 203,527	$ (5,786)	$ (791)	$ 62,578	$ (12,552)	$ 247,281
Comprehensive income	—	—	—	—	—	12,567	(4,343)	8,224
Cumulative-effect adjustment due to change in accounting principle (ASU 2016-01)	—	—	—	—	—	(237)	237	—
Common stock held by ESOP committed to be released (90,978 shares)	—	—	271	461	—	—	—	732
Share-based compensation - equity incentive plan	—	—	—	—	707	—	—	707
Common stock repurchased	(1,137,916)	(11)	(12,256)	—	—	—	—	(12,267)
Issuance of common stock in connection with stock option exercises	18,975	—	114	—	—	—	—	114
Issuance of common stock in connection with equity incentive plan	85,440	1	925	—	(926)	—	—	—
Cash dividends declared and paid ($0.12 per share)	—	—	—	—	—	(3,506)	—	(3,506)
BALANCE AT SEPTEMBER 30, 2018	29,453,808	$ 295	$ 192,581	$ (5,325)	$ (1,010)	$ 71,402	$ (16,658)	$ 241,285

See accompanying notes to unaudited consolidated financial statements.

WESTERN NEW ENGLAND BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED
(Dollars in thousands)

	Nine Months Ended September 30,	
	2018	**2017**
OPERATING ACTIVITIES:		
Net income	$ 12,567	$ 12,674
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,600	850
Depreciation and amortization of premises and equipment	1,530	1,468
Accretion of purchase accounting adjustments, net	(1,052)	(1,431)
Amortization of core deposit intangible	282	282
Net amortization of premiums and discounts on securities and mortgage loans	1,839	2,577
Share-based compensation expense	707	490
ESOP expense	732	698
Unrealized losses on marketable equity securities, net	190	—
Net loss (gain) on redemption and sales of securities	250	(52)
Gain on sale of other real estate owned	(48)	(67)
Deferred income tax benefit	—	(973)
Income from bank-owned life insurance	(1,374)	(1,369)
Bank-owned life insurance death benefits	(715)	—
Net change in:		
Accrued interest receivable	115	18
Other assets	552	(3,578)
Other liabilities	3,205	1,995
Net cash provided by operating activities	20,380	13,582
INVESTING ACTIVITIES:		
Securities, available for sale:		
Purchases	(12,146)	(67,246)
Proceeds from redemptions and sales	12,501	22,453
Proceeds from calls, maturities, and principal collections	18,393	46,576
Purchase of residential mortgages	—	(48,205)
Loan originations and principal payments, net	(61,445)	(4,133)
Redemption of Federal Home Loan Bank of Boston stock	73	420
Proceeds from sale of other real estate owned	203	365
Purchases of premises and equipment	(2,565)	(1,645)
Proceeds from sale of premises and equipment	45	—
Proceeds from payout on bank-owned life insurance	2,050	—
Net cash used in investing activities	(42,891)	(51,415)
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	103,164	(2,120)
Net change in short-term borrowings	(89,650)	20,114
Repayment of long-term debt	(53,322)	(19,700)
Proceeds from long-term debt	113,000	1,420
Cash dividends paid	(3,506)	(2,690)
Common stock repurchased	(12,422)	(5,990)
Issuance of common stock in connection with stock option exercises	114	5,465
Net cash provided by (used in) financing activities	57,378	(3,501)
NET CHANGE IN CASH AND CASH EQUIVALENTS:	34,867	(41,334)
Beginning of period	27,132	70,234
End of period	$ 61,999	$ 28,900
Supplemental cash flow information:		
Net change in cash due to broker for common stock repurchased	$ (155)	$ (318)
Interest paid	13,433	10,774
Taxes paid	2,507	3,658

See the accompanying notes to unaudited consolidated financial statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations – Western New England Bancorp, Inc. ("Western New England Bancorp," "WNEB," the "Company," "we" or "us") is a Massachusetts-chartered stock holding company for Westfield Bank, a federally chartered stock savings bank (the "Bank").

The Bank's deposits are insured to the limits specified by the Federal Deposit Insurance Corporation ("FDIC"). The Bank operates 22 banking offices in western Massachusetts and northern Connecticut, and its primary sources of revenue are earnings on loans to small and middle-market businesses and to residential property homeowners and income from securities.

Wholly-Owned Subsidiaries and Acquisition – Elm Street Securities Corporation, WFD Securities, Inc. and CSB Colts, Inc., are Massachusetts-chartered securities corporations, formed for the primary purpose of holding qualified securities. WB Real Estate Holdings, LLC, is a Massachusetts-chartered limited liability company that holds real property acquired as security for debts previously contracted by the Bank.

On October 21, 2016, we acquired Chicopee Bancorp, Inc. ("Chicopee"), the holding company for Chicopee Savings Bank. The acquisition added eight full-service banking offices located in western Massachusetts. The primary purpose of the acquisition with Chicopee was to expand our presence in western Massachusetts and diversify our market area. The transaction qualified as a tax-free reorganization for federal income tax purposes. Merger consideration paid in the transaction to shareholders of Chicopee totaled $98.8 million, consisting of 11,919,412 shares of Company common stock, net of shares of Chicopee already owned, and shares of Chicopee's ESOP liquidated to pay off the ESOP loan.

We accounted for the transaction using the acquisition method. The acquisition method requires an acquirer to recognize the assets acquired and the liabilities assumed at fair value as of the acquisition date. Additionally, our results of operations include Chicopee's operating results from the date of acquisition.

Principles of Consolidation – The unaudited consolidated financial statements include the accounts of Western New England Bancorp, the Bank, CSB Colts, Inc., Elm Street Securities Corporation, WB Real Estate Holdings, LLC and WFD Securities, Inc. All material intercompany balances and transactions have been eliminated in consolidation.

Estimates – The preparation of unaudited consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of income and expenses for both at the date of the unaudited consolidated financial statements. Actual results could differ from those estimates. Estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the realizability of deferred tax assets.

Basis of Presentation – In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our financial condition as of September 30, 2018, and the results of operations, changes in shareholders' equity and cash flows for the interim periods presented. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results of operations for the year ending December 31, 2018. Certain information and disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been omitted pursuant to the rules and regulations of the SEC.

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2017, included in our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Annual Report").

Reclassifications – Amounts in the prior period financial statements are reclassified when necessary to conform to the current year presentation.

2. EARNINGS PER SHARE

Basic earnings per share represent income available to shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential shares had been issued, as well as any adjustment to income that would result from the assumed issuance. No dilutive potential shares were outstanding during the periods presented. Share-based compensation awards that qualify as participating securities (entitled to receive non-forfeitable dividends) are included in basic earnings per share.

Earnings per common share for the three and nine months ended September 30, 2018 and 2017 have been computed based on the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
	(In thousands, except per share data)			
Net income applicable to common stock	$ 3,909	$ 3,815	$ 12,567	$ 12,674
Average number of common shares issued	29,627	31,001	29,958	30,799
Less: Average unallocated ESOP Shares	(745)	(838)	(768)	(861)
Less: Average unvested equity incentive plan shares	(93)	(60)	(90)	(42)
Average number of common shares outstanding used to calculate basic earnings per common share	28,789	30,103	29,100	29,896
Effect of dilutive equity incentive plan	49	26	42	12
Effect of dilutive stock options	99	90	100	166
Average number of common shares outstanding used to calculate diluted earnings per common share	28,937	30,219	29,242	30,074
Basic earnings per share	$ 0.14	$ 0.13	$ 0.43	$ 0.42
Diluted earnings per share	$ 0.14	$ 0.13	$ 0.43	$ 0.42

3. COMPREHENSIVE INCOME/LOSS

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income (loss).

The components of accumulated other comprehensive loss included in shareholders' equity are as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
Net unrealized losses on securities available-for-sale	$ (13,167)	$ (5,358)
Tax effect	3,286	1,316
Net-of-tax amount	(9,881)	(4,042)
Fair value of derivatives used for cash flow hedges	(712)	(2,152)
Termination fees on cancelled cash flow hedges	(2,864)	(3,664)
Total derivatives	(3,576)	(5,816)
Tax effect	1,006	1,635
Net-of-tax amount	(2,570)	(4,181)
Unrecognized actuarial loss on defined benefit plan	(5,851)	(6,021)
Tax effect	1,644	1,692
Net-of-tax amount	(4,207)	(4,329)
Accumulated other comprehensive loss	$ (16,658)	$ (12,552)

The following table presents changes in accumulated other comprehensive loss for the periods ended September 30, 2018 and 2017 by component:

	Securities	Derivatives	Defined Benefit Plan	Accumulated Other Comprehensive Loss
		(In thousands)		
Balance at December 31, 2016	$ (3,839)	$ (5,204)	$ (3,618)	$ (12,661)
Current-period other comprehensive income	1,454	1,275	465	3,194
Balance at September 30, 2017	$ (2,385)	$ (3,929)	$ (3,153)	$ (9,467)
Balance at December 31, 2017	$ (4,042)	$ (4,181)	$ (4,329)	$ (12,552)
Cumulative-effect adjustment due to change in accounting principle (ASU 2016-01)	237	—	—	237
Current-period other comprehensive (loss) income	(6,076)	1,611	122	(4,343)
Balance at September 30, 2018	$ (9,881)	$ (2,570)	$ (4,207)	$ (16,658)

4. SECURITIES

Securities available-for-sale are summarized as follows:

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Available-for-sale securities:				
Government-sponsored mortgage-backed securities	$ 167,601	$ 2	$ (8,672)	$ 158,931
U.S. government guaranteed mortgage-backed securities	20,507	—	(1,060)	19,447
Corporate bonds	49,915	—	(1,533)	48,382
State and municipal bonds	2,978	22	(88)	2,912
Government-sponsored enterprise obligations	25,150	—	(1,838)	23,312
Total available-for-sale	$ 266,151	$ 24	$ (13,191)	$ 252,984

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Available-for-sale securities:				
Government-sponsored mortgage-backed securities	$ 185,769	$ 10	$ (3,778)	$ 182,001
U.S. government guaranteed mortgage-backed securities	16,821	—	(567)	16,254
Corporate bonds	56,084	352	(292)	56,144
State and municipal bonds	3,222	36	(19)	3,239
Government-sponsored enterprise obligations	25,151	—	(770)	24,381
Mutual funds	6,727	—	(330)	6,397
Total available-for-sale securities	$ 293,774	$ 398	$ (5,756)	$ 288,416

At September 30, 2018, government-sponsored enterprise obligations with a fair value of $6.4 million and mortgage-backed securities with a fair value $70.8 million were pledged to secure public deposits and for other purposes as required or permitted by law. The securities collateralizing public deposits are subject to fluctuations in fair value. We monitor the fair value of the collateral on a periodic basis, and would pledge additional collateral if necessary based on changes in fair value of collateral or the balances of such deposits.

In 2018, the Company adopted Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) No. 2016-01, *Financial Instruments —Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which affects current U.S. GAAP primarily as it relates to the accounting for equity investments. ASU No. 2016-01 also supersedes the guidance that requires (1) classification of equity securities with readily determinable fair values into different categories (i.e., trading or available-for-sale), and (2) recognition of changes in fair value of available-for-sale securities in other comprehensive income.

The main significant effect resulting from the adoption of this ASU is that marketable equity securities previously reported within securities available-for-sale are now shown as a single line item (“Marketable equity securities”) in the Company’s balance sheet and the recognition in net income of the changes in fair value of Marketable equity securities. The cumulative-effect adjustment resulting from the adoption of this ASU was to decrease retained earnings and reduce accumulated other comprehensive loss as of January 1, 2018 by $237,000.

The amortized cost and fair value of available-for-sale debt securities at September 30, 2018, by final maturity, are shown below. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations. Also, because mortgage-backed securities require periodic principal paydowns, they are not included in the maturity categories in the following maturity summary.

	September 30, 2018	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale securities:		
Debt securities:		
Due in one year or less	$ 240	$ 241
Due after one year through five years	40,798	39,714
Due after five years through ten years	30,257	28,502
Due after ten years	6,748	6,149
Total securities	78,043	74,606
Mortgage-backed securities	188,108	178,378
Total	$ 266,151	$ 252,984

Gross realized gains and losses on sales of securities available-for-sale for the three and nine months ended September 30, 2018 and 2017 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Gross gains realized	$ —	$ 71	$ —	$ 117
Gross losses realized	—	(1)	(250)	(65)
Net gain realized	$ —	$ 70	$ (250)	$ 52

Proceeds from the sale and redemption of securities available-for-sale amounted to $12.5 million and $22.5 million for the nine months ended September 30, 2018 and 2017, respectively.

Information pertaining to securities with gross unrealized losses at September 30, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows:

	September 30, 2018							
	Less Than Twelve Months				Over Twelve Months			
	Number of Securities	Fair Value	Gross Unrealized Loss	Depreciation from Amortized Cost Basis (%)	Number of Securities	Fair Value	Gross Unrealized Loss	Depreciation from Amortized Cost Basis (%)
	(Dollars in thousands)							
Government-sponsored mortgage-backed securities	8	$ 18,257	$ 600	3.2%	70	$ 140,592	$ 8,072	5.4%
U.S. government guaranteed mortgage-backed securities	3	4,716	81	1.7	7	14,731	979	6.2
Government-sponsored enterprise obligations	0	—	—	—	9	23,312	1,838	7.3
Corporate bonds	9	33,244	788	2.3	6	15,138	745	4.7
State and municipal bonds	0	—	—	—	3	1,510	88	5.5
		$ 56,217	$ 1,469			$ 195,283	$ 11,722	

	December 31, 2017							
	Less Than Twelve Months				Over Twelve Months			
	Number of Securities	Fair Value	Gross Unrealized Loss	Depreciation from Amortized Cost Basis (%)	Number of Securities	Fair Value	Gross Unrealized Loss	Depreciation from Amortized Cost Basis (%)
	(Dollars in thousands)							
Government-sponsored mortgage-backed securities	21	$ 68,538	$ 613	0.9%	53	$ 111,595	$ 3,165	2.8%
U.S. government guaranteed mortgage-backed securities	1	1,205	23	1.8	6	15,049	544	3.5
Government-sponsored enterprise obligations	0	—	—	—	9	24,381	770	3.1
Corporate bonds	9	26,016	292	1.1	0	—	—	—
State and municipal bonds	0	—	—	—	3	1,581	19	1.2
Mutual funds	0	—	—	—	3	6,397	330	4.9
		$ 95,759	$ 928			$ 159,003	$ 4,828	

These unrealized losses are the result of changes in interest rates and not credit quality. Because we do not intend to sell the securities and it is more likely than not that we will not be required to sell the investments before recovery of their amortized cost basis, no declines are deemed to be other-than-temporary.

5. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans consisted of the following amounts:

	September 30, 2018	December 31, 2017
	(In thousands)	
Commercial real estate	$ 764,749	$ 732,616
Residential real estate:		
Residential	574,637	557,752
Home equity	95,645	92,599
Commercial and industrial	247,869	238,502
Consumer	5,105	4,478
Total Loans	1,688,005	1,625,947
Unearned premiums and deferred loan fees and costs, net	4,563	4,734
Allowance for loan losses	(12,235)	(10,831)
	$ 1,680,333	$ 1,619,850

There were no purchases of loans during the nine months ended September 30, 2018. During the nine months ended September 30, 2017, we purchased residential real estate loans aggregating $48.2 million.

We have transferred a portion of our originated commercial real estate and commercial and industrial loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in our accompanying unaudited consolidated balance sheets. We share ratably with our participating lenders in any gains or losses that may result from a borrower’s lack of compliance with contractual terms of the loan. We continue to service the loans on behalf of the participating lenders and, as such, collect cash payments from the borrowers, remit payments (net of servicing fees) to participating lenders and disburse required escrow funds to relevant parties. At September 30, 2018 and December 31, 2017, we serviced commercial loans for participants aggregating $35.7 million and $32.6 million, respectively.

Residential real estate loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid balances of these loans totaled $58.1 million and $65.8 million at September 30, 2018 and December 31, 2017, respectively. Net service fee income of $68,000 and $49,000 was recorded for the nine months ended September 30, 2018 and 2017, respectively, and is included in service charges and fees on the consolidated statements of net income.

Residential real estate mortgages are originated by the Bank both for its portfolio and for sale into the secondary market. The Bank may sell its loans to institutional investors such as the Federal Home Loan Mortgage Corporation. Under loan sale and servicing agreements with the investor, the Bank generally continues to service the residential real estate mortgages. The Bank pays the investor an agreed upon rate on the loan, which is less than the interest rate received from the borrower. The Bank retains the difference as a fee for servicing the residential real estate mortgages. The Bank capitalizes mortgage servicing rights at their fair value upon sale of the related loans, amortizes the asset over the estimated life of the serviced loan, and periodically assesses the asset for impairment. The significant assumptions used by a third party to estimate the fair value of capitalized servicing rights at September 30, 2018, include weighted average prepayment speed for the portfolio using the Public Securities Association Standard Prepayment Model (122 PSA), weighted average internal rate of return (12.04%), weighted average servicing fee (0.2501%), and average net cost to service loans ($83.84 per loan). The estimated fair value of capitalized servicing rights may vary significantly in subsequent periods primarily due to changing market interest rates, and their effect on prepayment speeds and discount rates.

A summary of the activity in the balances of mortgage servicing rights follows:

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
	(In thousands)	
Balance at the beginning of period:	$ 319	$ 352
Capitalized mortgage servicing rights	—	—
Amortization	(17)	(50)
Balance at the end of period	$ 302	$ 302
Fair value at the end of period	$ 469	$ 469

Loans are recorded at the principal amount outstanding, adjusted for charge-offs, unearned premiums and deferred loan fees and costs. Interest on loans is calculated using the effective yield method on daily balances of the principal amount outstanding and is credited to income on the accrual basis to the extent it is deemed collectable. Our general policy is to discontinue the accrual of interest when principal or interest payments are delinquent 90 days or more based on the contractual terms of the loan, or earlier if the loan is considered impaired. Any unpaid amounts previously accrued on these loans are reversed from income. Subsequent cash receipts are applied to the outstanding principal balance or to interest income if, in the judgment of management, collection of the principal balance is not in question. Loans are returned to accrual status when they become current as to both principal and interest and perform in accordance with contractual terms for a period of at least six months, reducing the concern as to the collectability of principal and interest. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income over the estimated average lives of the related loans.

The allowance for loan losses is established through provisions for loan losses charged to expense. Loans are charged-off against the allowance when management believes that the collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of general, allocated, and unallocated components, as further described below.

General component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate (includes one-to-four family and home equity), commercial real estate, commercial and industrial, and consumer. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: trends in delinquencies and nonperforming loans; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; and national and local economic trends and industry conditions. There were no changes in our policies or methodology pertaining to the general component of the allowance for loan losses during the periods presented for disclosure.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate – We require private mortgage insurance for all loans originated with a loan-to-value ratio greater than 80% and we do not grant subprime loans. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment. Home equity loans are secured by first or second mortgages on one-to-four family owner occupied properties.

Commercial real estate – Loans in this segment are primarily income-producing investment properties and owner-occupied commercial properties throughout New England. The underlying cash flows generated by the properties or operations can be adversely impacted by a downturn in the economy due to increased vacancy rates or diminished cash flows, which in turn, would have an effect on the credit quality in this segment. Management obtains financial information annually and continually monitors the cash flows of these loans.

Commercial and industrial loans – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Consumer loans – Loans in this segment are secured or unsecured and repayment is dependent on the credit quality of the individual borrower.

Allocated component

The allocated component relates to loans that are classified as impaired. Impaired loans are identified by analysis of loan performance, internal credit ratings and watch list loans that management believes are subject to a higher risk of loss. Impairment is measured on a loan-by-loan basis for commercial real estate and commercial and industrial loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual consumer and residential real estate loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring agreement.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. We determine the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Unallocated component

An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance, if any, reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

An analysis of changes in the allowance for loan losses by segment for the periods ended September 30, 2018 and 2017 is as follows:

	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer	Unallocated	Total
			(In thousands)			
Three Months Ended						
Balance at June 30, 2017	$ 4,472	$ 3,126	$ 2,754	$ 53	$ 13	$ 10,418
Provision (credit)	(68)	146	(109)	83	148	200
Charge-offs	—	(107)	—	(104)	—	(211)
Recoveries	—	80	3	28	—	111
Balance at September 30, 2017	$ 4,404	$ 3,245	$ 2,648	$ 60	$ 161	$ 10,518
Balance at June 30, 2018	$ 5,458	$ 3,529	$ 2,922	$ 92	$ (15)	$ 11,986
Provision (credit)	(389)	481	211	45	2	350
Charge-offs	—	(393)	(30)	(40)	—	(463)
Recoveries	334	9	8	11	—	362
Balance at September 30, 2018	$ 5,403	$ 3,626	$ 3,111	$ 108	$ (13)	$ 12,235
Nine Months Ended						
Balance at December 31, 2016	$ 4,083	$ 2,862	$ 3,085	$ 38	$ —	$ 10,068
Provision (credit)	239	427	(180)	203	161	850
Charge-offs	(36)	(148)	(285)	(237)	—	(706)
Recoveries	118	104	28	56	—	306
Balance at September 30, 2017	$ 4,404	$ 3,245	$ 2,648	$ 60	$ 161	$ 10,518
Balance at December 31, 2017	$ 4,712	$ 3,311	$ 2,733	$ 71	$ 4	$ 10,831
Provision (credit)	322	762	415	118	(17)	1,600
Charge-offs	—	(473)	(55)	(125)	—	(653)
Recoveries	369	26	18	44	—	457
Balance at September 30, 2018	$ 5,403	$ 3,626	$ 3,111	$ 108	$ (13)	$ 12,235

Further information pertaining to the allowance for loan losses by segment at September 30, 2018 and December 31, 2017 follows:

	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer	Unallocated	Total
			(In thousands)			
September 30, 2018						
Amount of allowance for impaired loans	$ —	$ —	$ —	$ —	$ —	$ —
Amount of allowance for non-impaired loans	5,403	3,626	3,111	108	(13)	12,235
Total allowance for loan losses	$ 5,403	$ 3,626	$ 3,111	$ 108	$ (13)	$ 12,235
Impaired loans	$ 2,907	$ 4,525	$ 3,547	$ 61	$ —	$ 11,040
Non-impaired loans	750,636	662,534	243,380	5,044	—	1,661,594
Loans acquired with deteriorated credit quality	11,206	3,223	942	—	—	15,371
Total loans	$ 764,749	$ 670,282	$ 247,869	$ 5,105	$ —	$ 1,688,005
December 31, 2017						
Amount of allowance for impaired loans	$ —	$ —	$ —	$ —	$ —	$ —
Amount of allowance for non-impaired loans	4,712	3,311	2,733	71	4	10,831
Total allowance for loan losses	4,712	$ 3,311	$ 2,733	$ 71	$ 4	$ 10,831
Impaired loans	$ 3,674	$ 3,964	$ 2,766	$ 120	$ —	$ 10,524
Non-impaired loans	716,571	642,787	234,582	4,358	—	1,598,298
Loans acquired with deteriorated credit quality	12,371	3,600	1,154	—	—	17,125
Total loans	$ 732,616	$ 650,351	$ 238,502	$ 4,478	$ —	$ 1,625,947

The following is a summary of past due and non-accrual loans by class at September 30, 2018 and December 31, 2017:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due	Past Due 90 Days or More and Still Accruing	Non-Accrual Loans
	(In thousands)					
September 30, 2018						
Commercial real estate	$ 751	$ 2,805	$ 471	$ 4,027	$ —	$ 2,405
Residential real estate:						
Residential	2,606	582	1,510	4,698	—	5,891
Home equity	321	96	60	477	—	692
Commercial and industrial	681	253	748	1,682	—	3,734
Consumer	58	—	18	76	—	60
Total	$ 4,417	$ 3,736	$ 2,807	$ 10,960	$ —	$ 12,782
December 31, 2017						
Commercial real estate	$ 1,951	$ 144	$ 290	$ 2,385	$ —	$ 2,959
Residential real estate:						
Residential	2,992	1,480	1,911	6,383	—	5,961
Home equity	635	—	48	683	—	696
Commercial and industrial	1,731	797	162	2,690	—	3,019
Consumer	65	—	41	106	—	120
Total	$ 7,374	$ 2,421	$ 2,452	$ 12,247	$ —	$ 12,755

The following is a summary of impaired loans by class at September 30, 2018 and December 31, 2017:

	At September 30, 2018[1]		Three Months Ended September 30, 2018		Nine Months Ended[1] September 30, 2018	
	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)					
Impaired Loans[1]:						
Commercial real estate	$ 14,113	$ 16,967	$ 14,240	$ 186	$ 14,736	$ 558
Residential real estate	7,008	8,019	7,302	14	6,949	33
Home equity	740	782	613	1	652	3
Commercial and industrial	4,489	9,023	4,413	34	4,201	106
Consumer	61	70	78	—	93	—
Total impaired loans	$ 26,411	$ 34,861	$ 26,646	$ 235	$ 26,631	$ 700

(1) Includes loans acquired with deteriorated credit quality and performing troubled debt restructurings.

	At December 31, 2017		Three Months Ended September 30, 2017		Nine Months Ended September 30, 2017	
	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)					
Impaired Loans[1]:						
Commercial real estate	$ 16,045	$ 18,773	$ 17,731	$ 199	$ 18,788	$ 650
Residential real estate	6,816	7,298	7,016	11	6,548	34
Home equity	748	783	407	1	260	3
Commercial and industrial	3,920	9,215	4,442	54	4,538	183
Consumer	120	129	122	—	83	—
Total impaired loans	$ 27,649	$ 36,198	$ 29,718	$ 265	$ 30,217	$ 870

(1) Includes loans acquired with deteriorated credit quality and performing troubled debt restructurings.

No interest income was recognized for impaired loans on a cash-basis method during the three and nine months ended September 30, 2018 or 2017. Interest income recognized on impaired loans during the three and nine months ended September 30, 2018 and 2017 related to performing purchase impaired loans and troubled debt restructuring ("TDRs").

We may periodically agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a TDR. These concessions could include a reduction in the interest rate on the loan, payment extensions, postponement or forgiveness of principal, forbearance or other actions intended to maximize collection. All TDRs are classified as impaired.

When we modify loans in a TDR, we measure impairment similar to other impaired loans based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or use the current fair value of the collateral, less selling costs for collateral dependent loans. If we determine that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance. In periods subsequent to modification, we evaluate all TDRs, including those that have payment defaults, for possible impairment and recognize impairment through the allowance.

Nonperforming TDRs are shown as nonperforming assets. There were no loans modified as TDRs during the three and nine months ended September 30, 2018 or 2017.

A default occurs when a loan is 30 days or more past due. No TDRs defaulted within twelve months of restructuring during the three and nine months ended September 30, 2018 or 2017.

There were no charge-offs on TDRs during the three and nine months ended September 30, 2018 or 2017.

Loans Acquired with Deteriorated Credit Quality

The following is a summary of loans acquired with evidence of credit deterioration from Chicopee as of September 30, 2018 and 2017.

	Contractual Required Payments Receivable	Cash Expected To Be Collected	Non-Accretable Discount	Accretable Yield	Loans Receivable
			(In thousands)		
Balance at December 31, 2017	$ 29,362	$ 23,158	$ 6,204	$ 6,033	$ 17,125
Collections	(3,370)	(2,258)	(1,112)	(504)	(1,754)
Dispositions	—	—	—	—	—
Balance at September 30, 2018	$ 25,992	$ 20,900	$ 5,092	$ 5,529	$ 15,371

	Contractual Required Payments Receivable	Cash Expected To Be Collected	Non-Accretable Discount	Accretable Yield	Loans Receivable
			(In thousands)		
Balance at December 31, 2016	$ 37,437	$ 29,040	$ 8,397	$ 7,521	$ 21,519
Collections	(3,860)	(3,326)	(534)	(1,003)	(2,323)
Dispositions	(1,833)	(1,503)	(330)	6	(1,509)
Balance at September 30, 2017	$ 31,744	$ 24,211	$ 7,533	$ 6,524	$ 17,687

Credit Quality Information

We utilize an eight-grade internal loan rating system for commercial real estate and commercial and industrial loans. Performing residential real estate, home equity and consumer loans are grouped with “Pass” rated loans. Nonperforming residential real estate, home equity and consumer loans are monitored individually for impairment and risk rated as “Substandard.”

Loans rated 1 – 4 are considered “Pass” or “Pass Watch” rated loans with acceptable risk.

Loans rated 5 are considered “Special Mention.” These loans exhibit potential credit weaknesses or downward trends and are being closely monitored by us.

Loans rated 6 are considered “Substandard.” Generally, a loan is considered “Substandard” if the borrower exhibits a well-defined weakness that may be inadequately protected by the current net worth and cash flow capacity to pay the current debt.

Loans rated 7 are considered “Doubtful.” Loans classified as “Doubtful” have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable and that a partial loss of principal is likely.

Loans rated 8 are considered uncollectible and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, we formally review the ratings on all commercial real estate and commercial and industrial loans. Construction loans are reported within commercial real estate loans and total $103.6 million and $84.4 million at September 30, 2018 and December 31, 2017, respectively. We engage an independent third party to review a significant portion of loans within these segments on a semi-annual basis. We use the results of these reviews as part of our annual review process. In addition, management utilizes delinquency reports, the watch list and other loan reports to monitor credit quality in other segments.

The following table presents our loans by risk rating at September 30, 2018 and December 31, 2017:

	Commercial Real Estate	Residential 1-4 Family	Home Equity	Commercial and Industrial	Consumer	Total
			(In thousands)			
September 30, 2018						
Loans rated 1 – 4	$ 731,634	$ 567,957	$ 94,720	$ 212,202	$ 5,045	$ 1,611,558
Loans rated 5	14,506	—	—	11,373	—	25,879
Loans rated 6	18,609	6,680	925	24,294	60	50,568
	$ 764,749	$ 574,637	$ 95,645	$ 247,869	$ 5,105	$ 1,688,005
December 31, 2017						
Loans rated 1 – 4	$ 708,992	$ 551,469	$ 91,903	$ 205,537	$ 4,475	$ 1,562,376
Loans rated 5	15,098	—	—	24,565	—	39,663
Loans rated 6	8,526	6,283	696	8,400	3	23,908
	$ 732,616	$ 557,752	$ 92,599	$ 238,502	$ 4,478	$ 1,625,947

6. GOODWILL AND OTHER INTANGIBLES

At September 30, 2018 and December 31, 2017, the Company's goodwill related to the acquisition of Chicopee in October 2016. No goodwill impairment was recorded for the nine months ended September 30, 2018. Annually, or more frequently if events or changes in circumstances warrant such evaluation, the Company evaluates its goodwill for impairment.

Core Deposit Intangibles

In connection with the acquisition of Chicopee, the Bank recorded a core deposit intangible of $4.5 million which is amortized over twelve years using the straight-line method. Amortization expense was $282,000 for the nine months ended September 30, 2018. At September 30, 2018, future amortization of the core deposit intangible totals $375,000 for each of the next five years and $1.9 million thereafter.

7. SHARE-BASED COMPENSATION

Stock Options – Under the terms of the Chicopee merger agreement dated October 21, 2016, each option to purchase shares of Chicopee common stock issued by Chicopee and outstanding at the effective time of the merger pursuant to the Chicopee 2007 Equity Incentive Plan fully vested and converted into an option to purchase shares of WNEB common stock on the same terms and conditions as were applicable before the merger, except (1) the number of shares of WNEB common stock subject to the new option was adjusted to be equal to the product of the number of shares of Chicopee common stock subject to the existing option and the exchange ratio (rounding fractional shares to the nearest whole share) and (2) the exercise price per share of WNEB common stock under the new option was adjusted to be equal to the exercise price per share of Chicopee common stock of the existing option divided by the exchange ratio (rounded to the nearest whole cent).

A summary of stock option activity for the nine months ended September 30, 2018 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2017	257,050	$ 6.31	4.41	$ 1,175
Exercised	(18,975)	$ 6.03	3.80	$ 89
Outstanding at September 30, 2018	238,075	$ 6.33	3.69	$ 1,058
Exercisable at September 30, 2018	238,075	$ 6.33	3.69	$ 1,058

Cash received for options exercised during the nine months ended September 30, 2018 was $114,000.

Restricted Stock Awards –In May 2014, our shareholders approved a stock-based compensation plan under which up to 516,000 shares of our common stock were reserved for grants of stock awards, including stock options and restricted stock, which may be granted to any officer, key employee or non-employee director of WNEB. Authorized but unissued shares are issued to awardees upon vesting of such awards. Any shares not issued because vesting requirements are not met will again be available for issuance under the plans.

In January 2015, 48,560 shares were granted under this plan and vest ratably over five years. The fair market value of shares awarded, based on the market price at the date of grant, was recorded as unearned compensation and is being amortized over the applicable vesting period.

In 2016, the Compensation Committee (the "Committee") approved the long-term incentive program (the "LTI Plan"). The LTI Plan provides a periodic award that is both performance and retention based in that it is designed to recognize the executive's responsibilities, reward demonstrated performance and leadership and to retain such executives. The objective of the LTI Plan is to align compensation for the named executive officers and directors over a multi-year period directly with the interests of our shareholders by motivating and rewarding creation and preservation of long-term financial strength, shareholder value and relative shareholder return.

The LTI Plan includes eligible officers of the Company who are nominated by the Company's Chief Executive Officer and approved by the Committee. The LTI Plan is triggered by the Company's achievement of satisfactory safety and soundness results from its most recent regulatory examination and additional performance metric as determined upon issuance. Stock grants made through the LTI Plan will be a combination of 50% time-vested restricted stock and 50% performance-based restricted stock.

In May 2016, 62,740 shares were granted under the LTI Plan. Of this total, 36,543 shares are retention-based, with 10,352 vesting in one year and 26,191 vesting ratably over a three-year period. The remaining 26,197 shares granted are performance based and are subject to the achievement of the 2016 long-term incentive performance metric before vesting is realized after a three-year period. Performance shares will be earned based upon how the Company performs relative to threshold and target absolute goals (i.e. Company-specific, not relative to a peer index) over the three-year performance period. As a result of the Tax Cuts and Jobs Act of 2017, the return on equity performance metrics were adjusted to incorporate the impact and benefits of the corporate tax rate reductions thereunder. The original and adjusted threshold and target metrics under the LTI Plan for 2016 are as follows:

	Return on Equity Metrics	
	Threshold	Target
Original metrics	5.85%	6.32%
Adjusted metrics	6.38%	6.79%

Participants will be able to earn between 50% (for threshold performance) and 100% (for target performance) of the performance shares but will not earn additional shares if performance exceeds target performance.

In May 2017, 89,042 shares were granted under the LTI Plan. Of this total, 55,159 shares are retention-based, with 21,276 vesting in one year and 33,883 vesting ratably over a three-year period. The remaining 33,883 shares granted are performance based and are subject to the achievement of the 2017 long-term incentive performance metric before vesting is realized after a three-year period. For the performance shares, the primary performance metric for 2017 awards is return on equity. Performance shares will be earned based upon how the Company performs relative to threshold, target and maximum absolute goals (i.e. Company-specific, not relative to a peer index) on an annual performance period, but will be distributed at the end of the three year period. As a result of the Tax Cuts and Jobs Act of 2017, the return on equity performance metrics were adjusted to incorporate the impact and benefits of the corporate tax rate reductions thereunder.

The original and adjusted threshold, target and maximum metrics under the LTI Plan for 2017 are as follows:

	Return on Equity Metrics					
Performance Period Ending	**Original Threshold**	**Adjusted Threshold**	**Original Target**	**Adjusted Target**	**Original Maximum**	**Adjusted Maximum**
December 31, 2018	6.30%	6.87%	7.00%	7.63%	7.60%	8.28%
December 31, 2019	6.50%	7.09%	7.20%	7.85%	7.90%	8.61%

Participants will be able to earn between 50% (for threshold performance), 100% (for target performance) and 150% (for maximum performance). The fair market value of shares awarded, based on the market price at the date of grant, is recorded as unearned compensation and amortized over the applicable vesting period. Shares granted under performance-based conditions are monitored on a quarterly basis in order to compare actual results to the performance metric established, with any necessary adjustments being recognized through share-based compensation expense and unearned compensation.

In January 2018, 83,812 shares were granted under the LTI Plan. Of this total, 50,852 shares are retention-based, with 17,908 vesting in one year and 32,944 vesting ratably over a three-year period. The remaining 32,960 shares granted are performance based and are subject to the achievement of the 2018 long-term incentive performance metric before vesting is realized after a three year period. For the performance shares, the primary performance metric for 2018 awards is return on equity. Performance shares will be earned based upon how the Company performs relative to threshold, target and maximum absolute goals (i.e. Company-specific, not relative to a peer index) on an annual performance period, but will be distributed at the end of the three-year period. The threshold, target and stretch metrics under the LTI Plan for 2018 are as follows:

	Return on Equity Metrics		
Performance Period Ending	**Threshold**	**Target**	**Stretch**
December 31, 2018	6.30%	6.80%	7.20%
December 31, 2019	6.85%	7.35%	7.75%
December 31, 2020	7.40%	7.90%	8.30%

Participants will be able to earn between 50% (for threshold performance), 100% (for target performance) and 150% (for maximum performance).The fair market value of shares awarded, based on the market price at the date of grant, is recorded as unearned compensation and amortized over the applicable vesting period. Shares granted under performance-based conditions are monitored on a quarterly basis in order to compare actual results to the performance metrics established, with any necessary adjustments being recognized through share-based compensation expense and unearned compensation.

At September 30, 2018, an additional 231,846 shares were available for future grants under the LTI Plan.

Our stock award plan activity for the nine months ended September 30, 2018 and 2017 is summarized below:

	Unvested Stock Awards Outstanding	
	Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2017	138,833	$ 8.98
Shares granted	83,812	11.05
Shares vested	(32,476)	9.13
Outstanding at September 30, 2018	190,169	$ 9.87
Outstanding at December 31, 2016	91,371	$ 7.51
Shares granted	89,042	10.15
Shares vested	(21,552)	7.44
Outstanding at September 30, 2017	158,861	$ 9.00

We recorded compensation cost related to the stock awards of $707,000 and $490,000 for the nine months ended September 30, 2018 and 2017, respectively.

8. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

We utilize short-term borrowings and long-term debt as an additional source of funds to finance our lending and investing activities and to provide liquidity for daily operations.

Short-term borrowings are made up of Federal Home Loan Bank of Boston ("FHLBB") advances with an original maturity of less than one year and a line of credit with the FHLBB. Short-term borrowings issued by the FHLBB were $55.0 million at September 30, 2018 and $133.0 million at December 31, 2017. We have an "Ideal Way" line of credit with the FHLBB for $9.5 million at September 30, 2018 and December 31, 2017. Interest on this line of credit is payable at a rate determined and reset by the FHLBB on a daily basis. The outstanding principal is due daily, but the portion not repaid will be automatically renewed. There were no advances outstanding on the line of credit at September 30, 2018 and December 31, 2017. There were no customer repurchase agreements at September 30, 2018 while there were $11.7 million at December 31, 2017. The customer repurchase agreements outstanding at December 31, 2017 were collateralized by government-sponsored enterprise obligations with fair value of $6.7 million and mortgage backed securities with a fair value of $58.4 million, respectively. A customer repurchase agreement is an agreement by us to sell to and repurchase from the customer an interest in specific securities issued by or guaranteed by the U.S. government. This transaction settles immediately on a same day basis in immediately available funds. Interest paid is commensurate with other products of equal interest and credit risk. In addition, we have lines of credit of $4.0 million and $50.0 million with Atlantic Community Bankers Bank ("ACBB") and PNC Bank, respectively. The interest rates on these lines are determined and reset on a daily basis by each respective bank. There were no advances outstanding under these lines of credit at September 30, 2018 or December 31, 2017. As part of our contract with ACBB, we are required to maintain a reserve balance of $300,000 with ACBB for our use of this line of credit.

Long-term debt consists of FHLBB advances with an original maturity of one year or more. At September 30, 2018, we had $224.3 million in long-term debt with the FHLBB. This compares to $164.8 million in long-term debt with the FHLBB at December 31, 2017.

All FHLBB advances are collateralized by a blanket lien on our residential real estate loans and eligible commercial real estate loans.

9. PENSION BENEFITS

We provide a defined benefit pension plan for eligible employees (the “Plan”). Employees must work a minimum of 1,000 hours per year to be eligible for the Plan. Eligible employees become vested in the Plan after five years of service. We plan to contribute to the Plan the amount required to meet the minimum funding standards under Section 412 of the Internal Revenue Code of 1986, as amended. Additional contributions will be made as deemed appropriate by management in conjunction with the Plan’s actuaries. We have not yet determined how much we expect to contribute to our Plan in 2018. No contributions have been made to the Plan for the nine months ended September 30, 2018. The Plan assets are invested in various pooled separate investment accounts offered by Principal Life Insurance Company, a division of Principal Financial Group, who is the custodian of the Plan (the “Custodian”). The Plan is administered by an officer of Westfield Bank (the “Plan Administrator”). On September 30, 2016, we effected a soft freeze on the Plan and therefore no new participants will be included in the Plan after such effective date.

The following table provides information regarding net pension benefit costs for the periods shown:

	Three Months Ended September 30,		Nine Months Ended, September 30,	
	2018	2017	2018	2017
	(In thousands)			
Service cost	$ 304	$ 245	$ 910	$ 778
Interest cost	253	254	759	761
Expected return on assets	(347)	(298)	(1,041)	(895)
Actuarial loss	56	51	170	153
Net periodic pension cost	$ 266	$ 252	$ 798	$ 797

10. DERIVATIVES AND HEDGING ACTIVITIES

Risk Management Objective of Using Derivatives

We are exposed to certain risks arising from both our business operations and economic conditions. We principally manage our exposures to a wide variety of business and operational risks through management of our core business activities. We manage economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of our assets and liabilities and the use of derivative financial instruments. Specifically, we entered into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. Our derivative financial instruments are used to manage differences in the amount, timing, and duration of our known or expected cash receipts and our known or expected cash payments principally related to certain variable rate loan assets and variable rate borrowings.

Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of our derivative financial instruments designated as hedging instruments as well as our classification on the balance sheet as of September 30, 2018 and December 31, 2017.

September 30, 2018	**Asset Derivatives**		**Liability Derivatives**	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
		(In thousands)		
Interest rate swaps	Other Assets	$ 4	Other Liabilities	$ 715

December 31, 2017	**Asset Derivatives**		**Liability Derivatives**	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
		(In thousands)		
Interest rate swaps	Other Assets	$ —	Other Liabilities	$ 2,152

At September 30, 2018 and December 31, 2017, all derivatives were designated as hedging instruments.

Cash Flow Hedges of Interest Rate Risk

Our objectives in using interest rate derivatives are to add stability to interest income and expense and to manage our exposure to interest rate movements. To accomplish this objective, we entered into interest rate swaps as part of our interest rate risk management strategy. These interest rate swaps are designated as cash flow hedges and involve the receipt of variable rate amounts from a counterparty in exchange for our making fixed payments.

The following table presents information about our cash flow hedges at September 30, 2018 and December 31, 2017:

September 30, 2018	**Notional Amount**	**Weighted Average Maturity**	**Weighted Average Rate**		**Estimated Fair Value**
			Receive	**Pay**	
	(In thousands)	(In years)			(In thousands)
Interest rate swaps on FHLBB borrowings	$ 55,000	2.5	2.34%	2.93%	$ (711)

December 31, 2017	**Notional Amount**	**Weighted Average Maturity**	**Weighted Average Rate**		**Estimated Fair Value**
			Receive	**Pay**	
	(In thousands)	(In years)			(In thousands)
Interest rate swaps on FHLBB borrowings	$ 55,000	3.3	1.64%	2.93%	$ (2,152)

For derivatives that are designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in accumulated other comprehensive income and subsequently reclassified into interest expense in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are received on the Company’s variable-rate borrowings. During the next twelve months, the Company estimates that an additional $1.3 million will be reclassified as an increase to interest expense.

We are hedging our exposure to the variability in future cash flows for forecasted transactions over a maximum period of six years (excluding forecasted payment of variable interest on existing financial instruments).

The table below presents the pre-tax net losses of our cash flow hedges for the periods indicated.

	Amount of Gain (Loss) Recognized in OCI on Derivative			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Interest rate swaps	$ 168	$ (14)	$ 1,086	$ (307)

Amounts reported in accumulated other comprehensive loss related to these derivatives are reclassified to interest expense as interest payments are made on our rate sensitive assets/liabilities. Fees on previously terminated swaps are being amortized as a reclassification of other comprehensive income into interest expense over the terms of the previously hedged borrowings. The amount reclassified from accumulated other comprehensive income into net income for interest rate swaps and termination fees was $351,000 and $497,000 during the three months ended September 30, 2018 and 2017, respectively and $1.2 million and $1.6 million during the nine months ended September 30, 2018 and 2017, respectively.

Credit-risk-related Contingent Features

By using derivative financial instruments, we expose ourselves to credit risk. Credit risk is the risk of failure by the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes us, which creates credit risk for us. When the fair value of a derivative is negative, we owe the counterparty and, therefore, it does not possess credit risk for us. The credit risk in derivative instruments is mitigated by entering into transactions with highly-rated counterparties that we believe to be creditworthy and by limiting the amount of our exposure to each counterparty.

We have agreements with our derivative counterparties that contain a provision where if we default on any of our indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then we could also be declared in default on our derivative obligations. We also have agreements with certain of our derivative counterparties that contain a provision where if we fail to maintain our status as “well capitalized”, then the counterparty could terminate the derivative positions and we would be required to settle our obligations under the agreements. Certain of our agreements with our derivative counterparties contain provisions where if a formal administrative action by a federal or state regulatory agency occurs that materially changes our creditworthiness in an adverse manner, we may be required to fully collateralize our obligations under the derivative instrument.

At September 30, 2018 and December 31, 2017, we had a net liability position of $708,000 and $2.2 million with our counterparties, respectively. As of September 30, 2018, we had minimum collateral posting thresholds with certain of our derivative counterparties and had mortgage-backed securities with a fair value of $1.0 million posted as collateral against our obligations under these agreements. If we had breached any of these provisions at September 30, 2018, we could have been required to settle our obligations under the agreements at the termination value.

11. FAIR VALUE OF ASSETS AND LIABILITIES

Determination of Fair Value

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for our various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Fair Value Hierarchy – We group our assets and liabilities that are measured at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value.

Level 1 – Valuation is based on quoted prices in active markets for identical assets. Level 1 assets generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets.

Level 2 – Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets. Level 3 assets include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Methods and assumptions for valuing our financial instruments are set forth below. Estimated fair values are calculated based on the value without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications or estimated transaction cost.

Securities and mortgage-backed securities – Fair value of securities are primarily measured using unadjusted information from an independent pricing service. The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market. These securities include marketable equity securities. All other securities are measured at fair value in Level 2 and are based on pricing models that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data.

Interest rate swaps – The valuation of our interest rate swaps is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves. We have determined that the majority of the inputs used to value our interest rate derivatives fall within Level 2 of the fair value hierarchy.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets:	(In thousands)			
Securities available-for-sale				
Government-sponsored mortgage-backed securities	$ —	$ 158,931	$ —	$ 158,931
U.S. government guaranteed mortgage-backed securities	—	19,447	—	19,447
Corporate bonds	—	48,382	—	48,382
State and municipal bonds	—	2,912	—	2,912
Government-sponsored enterprise obligations	—	23,312	—	23,312
Marketable equity securities	6,319	—	—	6,319
Interest rate swaps	—	4	—	4
Total assets	$ 6,319	$ 252,988	$ —	$ 259,307
Liabilities:				
Interest rate swaps	$ —	$ 715	$ —	$ 715

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:	(In thousands)			
Government-sponsored mortgage-backed securities	$ —	$ 182,001	$ —	$ 182,001
U.S. government guaranteed mortgage-backed securities	—	16,254	—	16,254
Corporate bonds	—	56,144	—	56,144
State and municipal bonds	—	3,239	—	3,239
Government-sponsored enterprise obligations	—	24,381	—	24,381
Mutual funds	6,397	—	—	6,397
Total assets	$ 6,397	$ 282,019	$ —	$ 288,416
Liabilities:				
Interest rate swaps	$ —	$ 2,152	$ —	$ 2,152

Also, we may be required, from time to time, to measure certain other assets at fair value on a non-recurring basis in accordance with U.S. GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related assets at September 30, 2018. Total losses represent the change in carrying value as a result of fair value adjustments related to assets still held at September 30, 2018. There were no assets measured at fair value on a non-recurring basis at September 30, 2017.

	At September 30, 2018			Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
	Level 1	Level 2	Level 3	Total Gains (Losses)	Total Gains (Losses)
		(In thousands)			
Impaired Loans	$ —	$ —	$ 970	$ (393)	$ (473)
Total Assets	$ —	$ —	$ 970	$ (393)	$ (473)

The amount of impaired loans represents the carrying value and related write-down and valuation allowance of impaired loans for which adjustments are based on the estimated fair value of the underlying collateral. The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on real estate appraisals performed by independent licensed or certified appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management will discount appraisals as deemed necessary based on the date of the appraisal and new information deemed relevant to the valuation. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value. The resulting losses were recognized in earnings through the provision for loan losses. Impaired loans with adjustments resulting from discounted cash flows or without a specific reserve are not included in this disclosure.

There were no transfers to or from Level 1 and 2 during the three and nine months ended September 30, 2018 and 2017. We did not measure any liabilities at fair value on a non-recurring basis on the consolidated balance sheets.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time our entire holdings of a particular financial instrument. Where quoted market prices are not available, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment. Changes in assumptions could significantly affect the estimates. The estimated fair values of our financial instruments are as follows:

	September 30, 2018				
	Carrying Value	Fair Value			
		Level 1	Level 2	Level 3	Total
			(In thousands)		
Assets:					
Cash and cash equivalents	$ 61,999	$ 61,999	$ —	$ —	$ 61,999
Securities available-for-sale	252,984	—	252,984	—	252,984
Marketable equity securities	6,319	6,319	—	—	6,319
Federal Home Loan Bank of Boston and other restricted stock	15,480	—	—	15,480	15,480
Loans - net	1,680,333	—	—	1,616,600	1,616,600
Accrued interest receivable	5,831	—	—	5,831	5,831
Mortgage servicing rights	302	—	469	—	469
Derivative assets	4	—	4	—	4
Liabilities:					
Deposits	1,609,019	—	—	1,603,546	1,603,546
Short-term borrowings	55,000	—	66,012	—	66,012
Long-term debt	224,306	—	212,931	—	212,931
Accrued interest payable	617	—	—	617	617
Derivative liabilities	715	—	715	—	715

	December 31, 2017				
	Carrying Value	Fair Value			
		Level 1	Level 2	Level 3	Total
			(In thousands)		
Assets:					
Cash and cash equivalents	$ 27,132	$ 27,132	$ —	$ —	$ 27,132
Securities available-for-sale	288,416	6,397	282,019	—	288,416
Federal Home Loan Bank of Boston and other restricted stock	15,553	—	—	15,553	15,553
Loans - net	1,619,850	—	—	1,581,929	1,581,929
Accrued interest receivable	5,946	—	—	5,946	5,946
Mortgage servicing rights	352	—	528	—	528
Liabilities:					
Deposits	1,506,082	—	—	1,503,311	1,503,311
Short-term borrowings	144,650	—	144,650	—	144,650
Long-term debt	164,786	—	164,016	—	164,016
Accrued interest payable	441	—	—	441	441
Derivative liabilities	2,152	—	2,152	—	2,152

12. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842), which supersedes the requirements in Topic 840, Leases. The objective of Topic 842 is to establish the principles that lessees and lessors shall apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in this ASU is permitted for all entities. Management is currently evaluating the impact to the consolidated financial statements of adopting this ASU but does not expect adoption to have a material impact on our consolidated financial statements. As of September 30, 2018, the Company had $8.7 million of future lease payments outstanding on operating leases pertaining to banking premises.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses* (Topic 326), which requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. The ASU also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. This ASU is effective for the first interim period in fiscal years beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is in the process of evaluating the standard. We have put together a project team that has begun to identify appropriate loan segments along with related historical losses for each segment and potential models that would be most appropriate for each individual segment. We have not quantified the effects of any models, but do expect the standard to significantly change the approach to calculating our allowance for loan losses.

In March 2017, the FASB issued ASU 2017-08—*Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20)*: *Premium Amortization on Purchased Callable Debt Securities*. This ASU amends guidance on the amortization period of premiums on certain purchased callable debt securities. Specifically, the amendments shorten the amortization period of premiums on certain purchased callable debt securities to the earliest call date. The amendments affect all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We do not expect the application of this guidance to have a material impact on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. This ASU removes and modifies the previously required disclosures relating to fair value measurements. Specifically, the ASU removes the required disclosure of amounts and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels, the valuation process for Level 3 fair value measurements and the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of a reporting period. It also modifies the required rollforward of Level 3 fair value measurements to a disclosure of any transfers into and out of Level 3, increases disclosure for investments in entities that calculate net asset value, and clarifies the measurement of uncertainty disclosure. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early application of the amendments in this ASU is permitted for all entities. Management is currently evaluating the impact to the consolidated financial statements of adopting this ASU but does not expect adoption to have a material impact on our consolidated financial statements.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Overview

We strive to remain a leader in meeting the financial service needs of our local community, and to provide quality service to the individuals and businesses in the market areas that we have served since 1853. Historically, we have been a community-oriented provider of traditional banking products and services to business organizations and individuals, including products such as residential and commercial loans, consumer loans and a variety of deposit products. We meet the needs of our local community through a community-based and service-oriented approach to banking.

We have adopted a growth-oriented strategy that has focused on increasing commercial lending. Our strategy also calls for increasing deposit relationships and broadening our product lines and services. We believe that this business strategy is best for our long-term success and viability, and complements our existing commitment to high-quality customer service. In connection with our overall growth strategy, we seek to:

- grow our commercial and industrial and commercial real estate loan portfolios by targeting businesses in our primary market areas of western Massachusetts and northern Connecticut as a means to increase the yield on and diversify our loan portfolio and build transactional deposit account relationships;

- focus on expanding our retail banking franchise and increase the number of households served within our market area; and

- supplement the commercial focus, grow the residential loan portfolio to diversify risk and deepen customer relationships.

You should read the following financial results for the three and nine months ended September 30, 2018 in the context of this strategy.

- Net income was $3.9 million, or $0.14 per diluted share, for the three months ended September 30, 2018, compared to $3.8 million, or $0.13 per diluted share, for the same period in 2017. For the nine months ended September 30, 2018, net income was $12.6 million, or $0.43 per diluted share, as compared to net income of $12.7 million, or $0.42 per diluted share, for the same period in 2017.

- The provision for loan losses was $350,000 and $200,000 for the three months ended September 30, 2018 and 2017, respectively, and $1.6 million and $850,000 for the nine months ended September 30, 2018 and 2017, respectively.

- Net interest income was $14.6 million and $14.8 million for the three months ended September 30, 2018 and 2017, respectively. The net interest margin was 2.94% for the three months ended September 30, 2018, compared to 3.04% for the same period in 2017. The net interest margin, on a fully tax-equivalent basis, was 2.96% for the three months ended September 30, 2018, compared to 3.09% for the same period in 2017. Net interest income was $45.2 million and $44.0 million for the nine months ended September 30, 2018 and 2017, respectively. The net interest margin was 3.09% and 3.04% for the nine months ended September 30, 2018 and 2017, respectively. The net interest margin, on a tax-equivalent basis, was 3.11% and 3.09% for the nine months ended September 30, 2018 and 2017, respectively.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with U.S. GAAP and practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Actual results could differ from those estimates.

Critical accounting estimates are necessary in the application of certain accounting policies and procedures, and are particularly susceptible to significant change. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. There have been no material changes to our critical accounting policies during the nine months ended September 30, 2018. For additional information on our critical accounting policies, please refer to the information contained in Note 1 of the accompanying unaudited consolidated financial statements and Note 1 of the consolidated financial statements included in our 2017 Annual Report.

COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2018 AND DECEMBER 31, 2017

At September 30, 2018, total assets of $2.2 billion reflect an increase of $67.5 million, or 3.2%, from December 31, 2017. During the same period, total loans increased $61.9 million, or 3.8%, while cash and cash equivalents increased $34.9 million, or 128.5%, and securities available-for-sale and marketable equity securities decreased $29.1 million, or 10.1%.

Total loans increased $61.9 million, or 3.8%, due to an increase in commercial real estate loans of $32.1 million, or 4.4%, an increase in residential loans, including home equity, of $19.9 million, or 3.1%, and an increase in commercial and industrial loans of $9.4 million, or 3.9%.

All loans where the payments are 90 days or more in arrears as of the closing date of each month are placed on nonaccrual status. Nonperforming loans were $12.8 million at September 30, 2018 and December 31, 2017, respectively. If all nonaccrual loans had been performing in accordance with their terms, we would have earned additional interest income of $654,000 and $580,000 for the nine months ended September 30, 2018 and 2017, respectively. At September 30, 2018 and December 31, 2017, our nonperforming loans to total loans were 0.76% and 0.78%, respectively, while our nonperforming assets to total assets were 0.59% and 0.62%, respectively. A summary of our nonaccrual and past due loans by class are listed in Note 5 of the accompanying unaudited consolidated financial statements.

At September 30, 2018, total deposits were $1.6 billion, an increase of $102.9 million, or 6.8%, from December 31, 2017. Core deposits, which the Company defines as all deposits except time deposits, increased $26.8 million, or 2.8%, from $949.5 million, or 63.0% of total deposits, at December 31, 2017, to $976.3 million, or 60.7% of total deposits, at September 30, 2018. Non-interest-bearing deposits increased $45.9 million, or 14.7%, to $357.8 million, while money market accounts decreased $5.2 million, or 1.3%, to $405.0 million, and interest-bearing checking accounts decreased $2.4 million, or 2.7%, to $85.0 million. Time deposits increased $76.2 million, or 13.7%, from $556.5 million at December 31, 2017 to $632.8 million at September 30, 2018.

Borrowings decreased $30.1 million, or 9.7%, to $279.3 million at September 30, 2018 from $309.4 million at December 31, 2017. Short-term borrowings decreased $89.7 million, or 62.0%, to $55.0 million at September 30, 2018 from $144.7 million at December 31, 2017 primarily due to a decrease in short-term FHLBB funding. In addition, customer repurchase agreements decreased $11.7 million. During the three months ended March 31, 2018, the Company eliminated customer repurchase agreements and balances were transferred to the customer's respective core deposit account. Long-term debt increased $59.5 million, or 36.1%, to $224.3 million at September 30, 2018 from $164.8 million at December 31, 2017. Management reduced a portion of its position in short-term adjustable-rate borrowings and increased its long-term fixed-rate funding in order to better manage rising funding costs due to the increase in the Federal Funds target rate. Additional information regarding short-term borrowings and long-term debt is included in Note 8 of the accompanying unaudited consolidated financial statements.

At September 30, 2018, shareholders' equity was $241.3 million, or 11.2% of total assets, compared to $247.3 million, or 11.9% of total assets, at December 31, 2017. The decrease in shareholders' equity during the nine months ended September 30, 2018 reflects $4.3 million net increase in accumulated other comprehensive loss, $12.3 million for the repurchase of shares of the Company's common stock and $3.5 million for payment of common stock dividends, partially offset by a net increase of $12.6 million in the Company's retained earnings reflective of current period net income and $1.6 million in share-based compensation.

COMPARISON OF OPERATING RESULTS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

General

Net income was $3.9 million, or $0.14 per diluted share, for the quarter ended September 30, 2018, compared to $3.8 million, or $0.13 per diluted share, for the same period in 2017. Net interest income was $14.6 million and $14.8 million for the three months ended September 30, 2018 and 2017, respectively.

Net Interest and Dividend Income

The following tables set forth the information relating to our average balance and net interest income for the three months ended September 30, 2018 and 2017, and reflect the average yield on interest-earning assets and average cost of interest-bearing liabilities for the periods indicated. Yields and costs are derived by dividing interest income by the average balance of interest-earning assets and interest expense by the average balance of interest-bearing liabilities for the periods shown. Average balances are derived from actual daily balances over the periods indicated. Interest income includes fees earned from making changes in loan rates and terms and fees earned when the real estate loans are prepaid or refinanced. For analytical purposes, the interest earned on tax-exempt assets is adjusted to a tax-equivalent basis to recognize the income tax savings which facilitates comparison between taxable and tax-exempt assets.

	Three Months Ended September 30,					
	2018			2017		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
	(Dollars in thousands)					
ASSETS:						
Interest-earning assets						
Loans(1)(2)	$ 1,682,034	$ 17,690	4.21%	$ 1,605,376	$ 16,681	4.16%
Securities(2)	263,378	1,772	2.69	302,030	1,901	2.52
Other investments	17,747	228	5.14	17,748	172	3.88
Short-term investments(3)	9,083	34	1.50	5,206	11	0.85
Total interest-earning assets	1,972,242	19,724	4.00	1,930,360	18,765	3.89
Total non-interest-earning assets	134,708			141,119		
Total assets	$ 2,106,950			$ 2,071,479		
LIABILITIES AND EQUITY:						
Interest-bearing liabilities						
Interest-bearing checking accounts	$ 86,615	$ 94	0.43%	$ 82,164	$ 81	0.39%
Savings accounts	138,112	40	0.12	148,433	43	0.12
Money market accounts	415,416	489	0.47	400,400	386	0.39
Time deposit accounts	600,333	2,471	1.65	568,578	1,601	1.13
Total interest-bearing deposits	1,240,476	3,094	1.00	1,199,575	2,111	0.70
Short-term borrowings and long-term debt	279,181	1,906	2.73	301,715	1,609	2.13
Interest-bearing liabilities	1,519,657	5,000	1.32	1,501,290	3,720	0.99
Non-interest-bearing deposits	328,735			300,757		
Other non-interest-bearing liabilities	16,917			16,147		
Total non-interest-bearing liabilities	345,652			316,904		
Total liabilities	1,865,309			1,818,194		
Total equity	241,641			253,285		
Total liabilities and equity	$ 2,106,950			$ 2,071,479		
Less: Tax-equivalent adjustment(2)		(119)			(249)	
Net interest and dividend income		$ 14,605			$ 14,796	
Net interest rate spread			2.66%			2.85%
Net interest rate spread, on a tax equivalent basis(4)			2.68%			2.90%
Net interest margin			2.94%			3.04%
Net interest margin, on a tax equivalent basis(5)			2.96%			3.09%
Ratio of average interest-earning assets to average interest-bearing liabilities			129.78%			128.58%

(1) Loans, including non-accrual loans, are net of deferred loan origination costs and unadvanced funds.

(2) Loan and securities income are presented on a tax-equivalent basis using a tax rate of 21% for the 2018 period and 35% for the 2017 period, respectively. The tax-equivalent adjustment is deducted from tax-equivalent net interest and dividend income to agree to the amount reported in the unaudited consolidated statements of net income. See “Explanation of Use of Non-GAAP Financial Measurements”.

(3) Short-term investments include federal funds sold.

(4) Net interest rate spread, on a tax-equivalent basis, represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities. See “Explanation of Use of Non-GAAP Financial Measurements”.

(5) Net interest margin, on a tax-equivalent basis, represents tax-equivalent net interest and dividend income as a percentage of average interest-earning assets. See “Explanation of Use of Non-GAAP Financial Measurements”.

The following table shows how changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to:

- interest income changes attributable to changes in volume (changes in volume multiplied by prior rate);
- interest income changes attributable to changes in rate (changes in rate multiplied by current volume); and
- the net change.

The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Three Months Ended September 30, 2018 compared to Three Months Ended September 30, 2017		
	Increase (Decrease) Due to		
	Volume	**Rate**	**Net**
Interest-earning assets		(In thousands)	
Loans[1]	$ 797	$ 212	$ 1,009
Securities[1]	(243)	114	(129)
Other investments	—	56	56
Short-term investments	8	15	23
Total interest-earning assets	562	397	959
Interest-bearing liabilities			
Interest-bearing checking accounts	4	9	13
Savings accounts	(3)	—	(3)
Money market accounts	14	89	103
Time deposit accounts	89	781	870
Short-term borrowing and long-time debt	(120)	417	297
Total interest-bearing liabilities	(16)	1,296	1,280
Change in net interest and dividend income[1]	$ 578	$ (899)	$ (321)

(1) Securities, loan income and change in net interest and dividend income are presented on a tax-equivalent basis using a tax rate of 21%. The tax-equivalent adjustment is deducted from tax-equivalent net interest income.

Net interest income decreased $191,000, or 1.3%, to $14.6 million, for the three months ended September 30, 2018, from $14.8 million for the three months ended September 30, 2017. The decrease in net interest income was due to a $1.3 million, or 34.4%, increase in interest expense, partially offset by an increase in interest income of $1.1 million, or 5.9%, during the same period. The increase in interest expense of 34.4% from September 30, 2017 was primarily due to an increase of $983,000, or 46.6%, in interest expense on deposits and an increase of $297,000, or 18.5%, in interest expense on borrowings.

The tax-equivalent net interest margin for the three months ended September 30, 2018 was 2.96%, compared to 3.09% during the three months ended September 30, 2017. The decrease in net interest margin was largely attributable to the decrease in purchase accounting adjustments, from a favorable adjustment of $448,000 for the three months ended September 30, 2017 to a negative adjustment of $62,000 for the three month ended September 30, 2018, which negatively impacted the margin by 10 basis points. Excluding the purchase accounting adjustments, the net interest margin was 2.97% for the three months ended September 30, 2018, compared to 3.00%, for the three months ended September 30, 2017. Also, negatively impacting the net interest margin was the reduction in the statutory federal income tax rate from 35% for the three months ended September 30, 2017 to 21% for three months ended September 30, 2018 which reduced the tax-equivalent adjustment and resulted in a three basis point decline in the fully tax equivalent net interest margin over the same period.

The average yield on interest-earning assets increased 11 basis points from 3.89% for the three months ended September 30, 2017 to 4.00% for the three months ended September 30, 2018. Excluding the purchase accounting adjustments in both periods and prepayment fee income in the September 2018 period, the average yield on interest-earning assets increased 17 basis points from 3.86% for the three months ended September 30, 2017 to 4.03% for the three months ended September 30, 2018, respectively. During the three months ended September 30, 2018, the average cost of funds increased 33 basis points from 0.99% for the three months ended September 30, 2017 to 1.32% for the three months ended September 30, 2018. The average cost of time deposits increased 52 basis points from 1.13% for the three months ended September 30, 2017 to 1.65% for the three months ended September 30, 2018. The average cost of deposits increased 30 basis points from 0.70% for the three months ended September 30, 2017 to 1.00% for the three months ended September 30, 2018, while the average cost of borrowings increased 60 basis points during the same period. For the three months ended September 30, 2018, average demand deposits of $328.7 million, an interest-free source of funds, represented 21.0% of average total deposits and increased $27.9 million, or 9.3%, from the three months ended September 30, 2017.

During the three months ended September 30, 2018, average interest-earning assets increased $41.9 million, or 2.2%, to $2.0 billion. The increase in average interest-earning assets was due to an increase in average loans of $76.7 million, or 4.8%, partially offset by a decrease in average securities of $38.7 million, or 12.8%.

Provision for Loan Losses

The provision for loan losses is reviewed by management based upon our evaluation of then-existing economic and business conditions affecting our key lending areas and other conditions, such as new loan products, credit quality trends (including trends in nonperforming loans expected to result from existing conditions), collateral values, loan volumes and concentrations, specific industry conditions within portfolio segments that existed as of the balance sheet date and the impact that such conditions were believed to have had on the collectability of the loan portfolio.

The amount of the provision for loan losses during the three months ended September 30, 2018 was based upon the changes that occurred in the loan portfolio during that same period. The changes in the loan portfolio, described in the comparison of financial condition, include an increase in commercial real estate loans, residential real estate loans and commercial and industrial loans. After evaluating these factors, we recorded a provision for loan losses of $350,000 for the three months ended September 30, 2018, compared to $200,000 for the same period in 2017. The allowance was $12.2 million and $10.8 million and 0.72% and 0.66% of total loans at September 30, 2018 and December 31, 2017, respectively.

Net charge-offs were $101,000, or 0.01% of average loans, for the three months ended September 30, 2018. This comprised charge-offs of $463,000 for the three months ended September 30, 2018, offset partially by recoveries of $362,000 during the same period.

Net charge-offs were $100,000, or 0.01% of average loans, for the three months ended September 30, 2017. This comprised charge-offs of $211,000 for the three months ended September 30, 2017, offset by recoveries of $111,000.

Although we believe that we have established and maintained the allowance for loan losses at adequate levels, future adjustments may be necessary if economic, real estate and other conditions differ substantially from the current operating environment.

Non-Interest Income

Non-interest income decreased $116,000, or 4.8%, to $2.3 million for the three months ended September 30, 2018, from $2.4 million for the three months ended September 30, 2017. The decrease of $116,000 in non-interest income was primarily due to a decrease in other income of $111,000, or 100%, an increase in unrealized losses on the Company’s marketable equity securities portfolio due to the adoption of ASU 2016-01 of $43,000, a decrease in gain on sale of securities of $70,000 and a decrease of $67,000 on the gain on sale of other real estate owned (“OREO”), partially offset by an increase in service charges and fees of $177,000, or 10.3%. The third quarter typically includes seasonal non-interest income, which was approximately $200,000 during the three months ended September 30, 2018.

Non-Interest Expense

For the three months ended September 30, 2018, non-interest expense increased $416,000, or 3.7%, to $11.6 million, or 2.18% of average assets, from $11.2 million, or 2.14% of average assets, for the three months ended September 30, 2017. The increase in non-interest expense was primarily due to an increase in other non-interest expense of $299,000, or 19.3%, an increase in professional fees of $125,000, or 19.5%, an increase in occupancy expense of $61,000, or 6.8%, and an increase in advertising expenses of $23,000, or 7.0%. These increases were partially offset by a decrease in salaries and benefits of $39,000, or 0.6%, a decrease in data processing of $38,000, or 5.6%, a decrease in furniture and equipment of $10,000, or 2.4%, and a decrease in FDIC insurance of $5,000, or 3.1%. The increase in professional fees of $125,000 was primarily due to $103,000 in legal fees associated with a previously charged-off loan from 2010 that resulted in the recovery of $300,000 during the three months ended September 30, 2018. The Company intends to continue to pursue legal remedies against the principals for recovery, but there can be no assurance that these efforts will result in significant recoveries.

Income Taxes

The Company’s effective tax rate decreased from 34.8% for the three months ended September 30, 2017 to 21.5% for the three months ended September 30, 2018 and reflects a reduction in the statutory federal income tax rate to 21% from 35% effective January 1, 2018 related to enactment of the Tax Cuts and Jobs Act (the “Tax Act”) in December 2017.

COMPARISON OF OPERATING RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

General

Net income was $12.6 million, or $0.43 per diluted share, for the nine months ended September 30, 2018, compared to $12.7 million, or $0.42 per diluted share, for the same period in 2017. Net interest income was $45.2 million and $44.0 million for the nine months ended September 30, 2018 and 2017, respectively.

Net Interest and Dividend Income

The following tables set forth the information relating to our average balance and net interest income for the nine months ended September 30, 2018 and 2017, and reflect the average yield on interest-earning assets and average cost of interest-bearing liabilities for the periods indicated. Yields and costs are derived by dividing interest income by the average balance of interest-earning assets and interest expense by the average balance of interest-bearing liabilities for the periods shown. Average balances are derived from actual daily balances over the periods indicated. Interest income includes fees earned from making changes in loan rates and terms and fees earned when the real estate loans are prepaid or refinanced. For analytical purposes, the interest earned on tax-exempt assets is adjusted to a tax-equivalent basis to recognize the income tax savings which facilitates comparison between taxable and tax-exempt assets.

	Nine Months Ended September 30,					
	2018			2017		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
	(Dollars in thousands)					
ASSETS:						
Interest-earning assets						
Loans[(1)(2)]	$ 1,658,094	$ 53,047	4.27%	$ 1,589,423	$ 49,202	4.13%
Securities[(2)]	272,844	5,422	2.65	305,111	5,761	2.52
Other investments	17,489	631	4.81	17,665	501	3.78
Short-term investments[(3)]	7,817	83	1.42	24,023	102	0.57
Total interest-earning assets	1,956,244	59,183	4.03	1,936,222	55,566	3.83
Total non-interest-earning assets	134,722			137,775		
Total assets	$ 2,090,966			$ 2,073,997		
LIABILITIES AND EQUITY:						
Interest-bearing liabilities						
Interest-bearing checking accounts	$ 92,718	261	0.38	$ 86,841	249	0.38
Savings accounts	141,314	129	0.12	150,975	137	0.12
Money market accounts	417,724	1,383	0.44	398,400	1,150	0.38
Time deposit accounts	580,243	6,394	1.47	568,728	4,643	1.09
Total interest-bearing deposits	1,231,999	8,167	0.88	1,204,944	6,179	0.68
Short-term borrowings and long-term debt	283,302	5,442	2.56	302,254	4,579	2.02
Interest-bearing liabilities	1,515,301	13,609	1.20	1,507,198	10,758	0.95
Non-interest-bearing deposits	317,296			304,492		
Other non-interest-bearing liabilities	16,460			13,774		
Total non-interest-bearing liabilities	333,756			318,266		
Total liabilities	1,849,057			1,825,464		
Total equity	241,909			248,533		
Total liabilities and equity	$ 2,090,966			$ 2,073,997		
Less: Tax-equivalent adjustment[(2)]		(382)			(766)	
Net interest and dividend income		$ 45,192			$ 44,042	
Net interest rate spread			2.81%			2.82%
Net interest rate spread, on a tax equivalent basis[(4)]			2.83%			2.86%
Net interest margin			3.09%			3.04%
Net interest margin, on a tax equivalent basis[(5)]			3.11%			3.09%
Ratio of average interest-earning assets to average interest-bearing liabilities			129.10%			128.47%

(1) Loans, including non-accrual loans, are net of deferred loan origination costs and unadvanced funds.

(2) Loan and securities income are presented on a tax-equivalent basis using a tax rate of 21% for the 2018 period and 35% for the 2017 period, respectively. The tax-equivalent adjustment is deducted from tax-equivalent net interest and dividend income to agree to the amount reported in the statements of net income. See “Explanation of Use of Non-GAAP Financial Measurements”.

(3) Short-term investments include federal funds sold.

(4) Net interest rate spread, on a tax equivalent basis, represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities. See “Explanation of Use of Non-GAAP Financial Measurements”.

(5) Net interest margin, on a tax equivalent basis, represents tax-equivalent net interest and dividend income as a percentage of average interest-earning assets. See “Explanation of Use of Non-GAAP Financial Measurements”.

The following table shows how changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to:

- interest income changes attributable to changes in volume (changes in volume multiplied by prior rate);
- interest income changes attributable to changes in rate (changes in rate multiplied by current volume); and
- the net change.

The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Nine Months Ended September 30, 2018 compared to Nine Months Ended September 30, 2017		
	Increase (Decrease) Due to		
	Volume	Rate	Net
Interest-earning assets		(In thousands)	
Loans[1]	$ 2,126	$ 1,719	$ 3,845
Securities[1]	(609)	270	(339)
Other investments	(5)	135	130
Short-term investments	(69)	50	(19)
Total interest-earning assets	1,443	2,174	3,617
Interest-bearing liabilities			
Interest-bearing checking accounts	17	(5)	12
Savings accounts	(9)	1	(8)
Money market accounts	56	177	233
Time deposit accounts	94	1,657	1,751
Short-term borrowing and long-term debt	(287)	1,150	863
Total interest-bearing liabilities	(129)	2,980	2,851
Change in net interest and dividend income	$ 1,572	$ (806)	$ 766

(1) Securities, loan income and change in net interest and dividend income are presented on a tax-equivalent basis using a tax rate of 21%. The tax-equivalent adjustment is deducted from tax-equivalent net interest income.

Net interest income increased $1.2 million, or 2.6%, from $44.0 million for the nine months ended September 30, 2017 to $45.2 million for the nine months ended September 30, 2018. The increase in net interest income was primarily due to an increase in interest and dividend income of $4.0 million, or 7.3%, partially offset by an increase in interest expense of $2.9 million, or 26.5%, from the nine months ended September 30, 2017. Excluding favorable purchase accounting adjustments of $1.1 million and prepayment penalties of $279,000 during the nine months ended September 30, 2018 and $1.4 million in favorable purchase accounting adjustments during the nine months ended September 30, 2017, net interest income increased $1.2 million, or 2.8%. After adjusting for the favorable purchase accounting adjustments and the prepayment penalties, interest income increased $3.5 million, or 6.5%, primarily due to an increase in average loans of $68.7 million, or 4.3%, for the nine months ended September 30, 2018. The increase in interest expense of $2.9 million, or 26.5%, was due to an increase in interest expense on deposits of $2.0 million, or 32.2%, and an increase in interest expense on borrowings of $863,000, or 18.8%, for the nine months ended September 30, 2018. Favorable purchase accounting adjustments on deposits decreased $526,000, or 69.9%, from $753,000 during the nine months ended September 30, 2017 to $227,000 during the nine months ended September 30, 2018. Excluding these adjustments, interest expense on deposits increased $1.5 million, or 21.1%, during the same period.

The tax-equivalent net interest margin increased two basis points from 3.09% for the nine months ended September 30, 2017 to 3.11% for the nine months ended September 30, 2018. During the nine months ended September 30, 2018 and September 30, 2017, favorable purchase accounting adjustments related to the Chicopee acquisition increased net interest income by $1.1 million and $1.4 million, respectively. The nine months ended September 30, 2018 also included prepayment penalties of $279,000. Excluding these items, the adjusted net interest margin for the nine months ended September 30, 2018 was 3.02% compared to 2.99% for the nine months ended September 30, 2017. Also, negatively impacting the net interest margin was the reduction in the statutory federal income tax rate from 35% for the nine months ended September 30, 2017 to 21% for nine months ended September 30, 2018, thus reducing the tax-equivalent amount of each dollar of tax-exempt income and causing a two basis point decline in net interest margin over the same period.

The average asset yield increased 20 basis points from 3.83% for the nine months ended September 30, 2017 to 4.03% for the nine months ended September 30, 2018. Excluding the favorable purchase accounting adjustments on loans of $697,000 and $483,000 for the nine months ended September 30, 2018 and 2017, the average loan yield increased 12 basis points from 4.09% for the nine months ended September 30, 2017 to 4.21% for the nine months ended September 30, 2018. The average cost of funds increased 25 basis points from 0.95% for the nine months ended September 30, 2017 to 1.20% for the nine months ended September 30, 2018. The average cost of time deposits increased 38 basis points from 1.09% for the nine months ended September 30, 2017 to 1.47% for the nine months ended September 30, 2018. Excluding the favorable purchase account adjustments on time deposits of $227,000 and $753,000 during the nine months ended September 30, 2018 and September 30, 2017, respectively, the cost of deposits increased 14 basis points from 0.77% during the nine months ended September 30, 2017 to 0.91% during the nine months ended September 30, 2018, respectively. The average cost of borrowings increased 54 basis points from 2.02% for the nine months ended September 30, 2017 to 2.56% for the nine months ended September 30, 2018.

Average interest-earning assets increased $20.0 million, or 1.0%, to $2.0 billion for the nine months ended September 30, 2018. The increase in average interest-earning assets was due to the increase in average loans of $68.7 million, or 4.3%, partially offset by the decrease in average investments of $32.3 million, or 10.6%, and a decrease in short-term investments of $16.2 million, or 67.5%.

Average FHLB borrowings decreased $4.7 million, or 1.7%, from $283.1 million for the nine months ended September 30, 2017 to $278.4 million for the nine months ended September 30, 2018. In order to manage interest rate risk, during the nine months ended September 30, 2018, average long-term FHLB borrowings of $205.0 million increased $84.3 million, or 69.8%, from $120.7 million for the nine months ended September 30, 2017, as short-term borrowings decreased $89.0 million, or 54.8%, during the same period. New long-term borrowings were used to replace a portion of our short-term borrowings that matured over the nine months in order to manage funding costs in a rising rate environment.

Provision for Loan Losses

The amount that we provided for loan losses during the nine months ended September 30, 2018 was based upon the changes that occurred in the loan portfolio during that same period. The changes in the loan portfolio for the nine months ended September 30, 2018, described in the comparison of financial condition, include increases in commercial real estate loans, residential real estate loans and commercial and industrial loans. After evaluating these factors, we recorded a provision of $1.6 million for loan losses for the nine months ended September 30, 2018, compared to $850,000 for the same period in 2017. The allowance was $12.2 million at September 30, 2018 and $10.8 million at December 31, 2017. The allowance for loan losses was 0.72% and 0.66% of total loans at September 30, 2018 and December 31, 2017, respectively.

Net charge-offs were $196,000, or 0.01% of average loans, for the nine months ended September 30, 2018. This comprised charge-offs of $653,000 for the nine months ended September 30, 2018, partially offset by recoveries of $457,000.

Net charge-offs were $400,000, or 0.03% of average loans, for the nine months ended September 30, 2017. This comprised charge-offs of $706,000 for the nine months ended September 30, 2017, partially offset by recoveries of $306,000.

Although we believe that we have established and maintained the allowance for loan losses at adequate levels, future adjustments may be necessary if economic, real estate and other conditions differ substantially from the current operating environment.

Non-Interest Income

For the nine months ended September 30, 2018, non-interest income of $7.0 million increased $491,000, or 7.5%, compared to $6.5 million for the nine months ended September 30, 2017. During the nine months ended September 30, 2018, non-interest income included the recognition of $715,000 in BOLI death benefits. Excluding the BOLI death benefits, non-interest income decreased $224,000, or 3.4%. The decrease was primarily due to an increase of $302,000 in realized securities losses primarily due to the amortization of the remaining premium on a bond that was paid in full prior to its final maturity, an increase of $190,000 in unrealized losses on the Company's marketable equity securities portfolio due to the adoption of ASU 2016-01, a decrease in other income of $96,000, or 42.3%, and a decrease of $19,000 on the gain on the sale of OREO, partially offset by an increase in service charges and fees of $378,000, or 7.9%, from $4.8 million for the nine months ended September 30, 2017 to $5.2 million for the nine months ended September 30, 2018.

Non-Interest Expense

For the nine months ended September 30, 2018, non-interest expense increased $1.1 million, or 3.4%, to $34.5 million, or 2.21% of average assets, compared to $33.4 million, or 2.15% of average assets for the nine months ended September 30, 2017. Excluding merger-related expenses of $526,000, non-interest expense increased $1.6 million, or 4.9%, from $32.9 million for the nine months ended September 30, 2017 to $34.5 million for the nine months ended September 30, 2018. The increase in non-interest expense was primarily due to the increase in salaries and benefits of $594,000, or 3.1%, an increase in data processing of $217,000, or 12.5%, an increase in professional fees of $188,000, or 9.8%, an increase in occupancy expense of $164,000, or 5.8%, an increase in advertising expense of $92,000, or 9.6%, and an increase in other expenses of $396,000, or 8.1%. The increase in professional fees of $188,000, or 9.8%, was primarily due to $254,000 in legal fees associated with a previously charged-off loan from 2010 which resulted in the recovery of $300,000 during the nine months ended September 30, 2018. The Company intends to continue to pursue legal remedies against the principals for recovery, but there can be no assurance that these efforts will result in significant recoveries.

Income Taxes

For the nine months ended September 30, 2018, we had a tax provision of $3.5 million as compared to $3.6 million for the same period in 2017. The effective tax rate for the nine months ended September 30, 2018 and September 30, 2017 was 21.7% and 22.1%, respectively. The comparable effective tax rate for the nine months ended September 30, 2017 was primarily due to the $1.8 million in tax benefits recorded on the reversal of a deferred tax valuation allowance and stock option exercises.

Explanation of Use of Non-GAAP Financial Measurements

We believe that it is common practice in the banking industry to present interest income and related yield information on tax-exempt loans and securities on a tax-equivalent basis and that such information is useful to investors because it facilitates comparisons among financial institutions. However, the adjustment of interest income and yields on tax-exempt loans and securities to a tax-equivalent amount may be considered to include financial information that is not in compliance with GAAP. A reconciliation from GAAP to non-GAAP is provided below.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018		2017		2018		2017	
	(Dollars in thousands)				(Dollars in thousands)			
	Interest	Average Yield	Interest	Average Yield	Interest	Average Yield	Interest	Average Yield
Loans (no tax adjustment)	$ 17,577	4.18%	$ 16,445	4.10%	$ 52,684	4.24%	$ 48,482	4.07%
Tax-equivalent adjustment[1]	113		236		363		720	
Loans (tax-equivalent basis)	$ 17,690	4.21%	$ 16,681	4.16%	$ 53,047	4.27%	$ 49,202	4.13%
Securities (no tax adjustment)	$ 1,766	2.68%	$ 1,888	2.50%	$ 5,403	2.64%	$ 5,715	2.50%
Tax-equivalent adjustment[1]	6		13		19		46	
Securities (tax-equivalent basis)	$ 1,772	2.69%	$ 1,901	2.52%	$ 5,422	2.65%	$ 5,761	2.52%
Net interest income (no tax adjustment)	$ 14,605		$ 14,796		$ 45,192		$ 44,042	
Tax-equivalent adjustment[1]	119		249		382		766	
Net interest income (tax-equivalent basis)	$ 14,724		$ 15,045		$ 45,574		$ 44,808	
Interest rate spread (no tax adjustment)		2.66%		2.85%		2.81%		2.82%
Net interest margin (no tax adjustment)		2.94%		3.04%		3.09%		3.04%

(1) The tax equivalent adjustment is based upon a 21% tax rate for the 2018 periods and a 35% tax rate for the 2017 periods.

LIQUIDITY AND CAPITAL RESOURCES

The term “liquidity” refers to our ability to generate adequate amounts of cash to fund loan originations, loan purchases, withdrawals of deposits and operating expenses. Our primary sources of liquidity are deposits, scheduled amortization and prepayments of loan principal and mortgage-backed securities, maturities and calls of securities and funds provided by operations. We also can borrow funds from the FHLBB based on eligible collateral of loans and securities. Our maximum additional borrowing capacity from the FHLBB at September 30, 2018 was $213.1 million. In addition, we have available lines of credit of $4.0 million and $50.0 million with ACBB and PNC Bank, respectively. The interest rates on these lines are determined and reset on a daily basis by each respective bank.

Liquidity management is both a daily and long-term function of business management. The measure of a company’s liquidity is its ability to meet its cash commitments at all times with available cash or by conversion of other assets to cash at a reasonable price. Loan repayments and maturing securities are a relatively predictable source of funds. However, deposit flow, calls of securities and repayments of loans and mortgage-backed securities are strongly influenced by interest rates, general and local economic conditions and competition in the marketplace. These factors reduce the predictability of the timing of these sources of funds. Management believes that we have sufficient liquidity to meet the Company’s current operating needs.

At September 30, 2018, we exceeded each of the applicable regulatory capital requirements. As of September 30, 2018, the most recent notification from the Office of Comptroller of the Currency categorized the Bank as “well-capitalized” under the regulatory framework for prompt corrective action. To be categorized as “well-capitalized” the Bank must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes would change our category. Our actual capital ratios of September 30, 2018 and December 31, 2017 are also presented in the following table.

	Actual		Minimum For Capital Adequacy Purpose		Minimum To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
September 30, 2018						
Total Capital *(to Risk Weighted Assets)*:						
Consolidated	$ 254,973	15.38%	$ 132,646	8.00%	N/A	N/A
Bank	243,173	14.69	132,411	8.00	$ 165,514	10.00%
Tier 1 Capital (*to Risk Weighted Assets*):						
Consolidated	242,738	14.64	99,485	6.00	N/A	N/A
Bank	230,938	13.95	99,308	6.00	132,411	8.00
Common Equity Tier 1 Capital (*to Risk Weighted Assets*)						
Consolidated	242,738	14.64	74,613	4.50	N/A	N/A
Bank	230,938	13.95	74,481	4.50	107,584	6.50
Tier 1 Leverage Ratio (*to Adjusted Average Assets*):						
Consolidated	242,738	11.54	84,136	4.00	N/A	N/A
Bank	230,938	10.99	84,056	4.00	105,070	5.00
December 31, 2017						
Total Capital *(to Risk Weighted Assets)*:						
Consolidated	$ 255,605	15.53%	$ 131,711	8.00%	N/A	N/A
Bank	245,380	14.94	131,367	8.00	$ 164,208	10.00%
Tier 1 Capital (*to Risk Weighted Assets*):						
Consolidated	244,774	14.87	98,783	6.00	N/A	N/A
Bank	234,549	14.28	98,525	6.00	131,367	8.00
Common Equity Tier 1 Capital (*to Risk Weighted Assets*)						
Consolidated	244,774	14.87	74,087	4.50	N/A	N/A
Bank	234,549	14.28	73,894	4.50	106,735	6.50
Tier 1 Leverage Ratio (*to Adjusted Average Assets*):						
Consolidated	244,774	11.84	82,702	4.00	N/A	N/A
Bank	234,549	11.36	82,584	4.00	103,230	5.00

We also have outstanding, at any time, a significant number of commitments to extend credit and provide financial guarantees to third parties. These arrangements are subject to strict credit control assessments. Guarantees specify limits to our obligations. Because many commitments and almost all guarantees expire without being funded in whole or in part, the contract amounts are not estimates of future cash flows. We are obligated under leases for certain of our branches and equipment. The following table summarizes the contractual obligations and credit commitments at September 30, 2018:

	Within 1 Year	After 1 Year But Within 3 Years	After 3 Year But Within 5 Years	After 5 Years	Total
			(In thousands)		
Lease Obligations					
Operating lease obligations[1]	$ 1,103	$ 1,953	$ 1,490	$ 4,213	$ 8,759
Borrowings					
Federal Home Loan Bank	121,447	146,424	10,777	658	279,306
Credit Commitments					
Available lines of credit	162,219	—	—	74,405	236,624
Other loan commitments	73,258	17,181	2,053	1,267	93,759
Letters of credit	9,285	1,358	301	698	11,642
Total credit commitments	244,762	18,539	2,354	76,370	342,025
Other Obligations					
Vendor Contracts	2,962	5,923	5,923	4,195	19,003
Total Obligations	$ 370,274	$ 172,839	$ 20,544	$ 85,436	$ 649,093

(1) Payments are for the lease of real property

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our assessment of our sensitivity to market risk since its presentation in our 2017 Annual Report. Please refer to Item 7A of the 2017 Annual Report for additional information.

ITEM 4: CONTROLS AND PROCEDURES

Disclosure Controls and Procedures.

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), as of the end of the period covered by this report. Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective, to ensure that information required to be disclosed in the reports we file and submit under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely discussion regarding required disclosure.

Changes in Internal Control Over Financial Reporting.

There have been no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during our last fiscal quarter that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are subject to claims and legal actions in the ordinary course of business. We believe that all such claims and actions currently pending against us, if any, are either adequately covered by insurance or would not have a material adverse effect on us if decided in a manner unfavorable to us.

ITEM 1A. RISK FACTORS.

For a summary of risk factors relevant to our operations, see Part 1, Item 1A, "Risk Factors" in our 2017 Annual Report. There are no material changes in the risk factors relevant to our operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

The following table sets forth information with respect to purchases made by us of our common stock during the three months ended September 30, 2018.

Period	Total Number of Shares Purchased	Average Price Paid per Share ($)	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that May Yet Be Purchased Under the Program(1)
July 1 - 31, 2018	48,986	10.92	48,986	1,548,606
Aug 1 - 31, 2018	128,178	10.86	128,178	1,420,428
Sept 1 - 30, 2018	117,735	10.84	117,735	1,302,693
Total	294,899	10.86	294,899	1,302,693

(1) On January 31, 2017, the Board of Directors authorized an additional stock repurchase program under which the Company may purchase up to 3,047,000 shares, or 10%, of its outstanding common stock.

There were no sales by us of unregistered securities during the three months ended September 30, 2018.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURE.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

EXHIBIT INDEX

Exhibit Number	Description
2.1	Agreement and Plan of Merger, dated as of April 4, 2016, by and between Western New England Bancorp, Inc. (f/k/a Westfield Financial, Inc.) and Chicopee Bancorp, Inc. (incorporated by reference to Exhibit 2.1 of the Form 8-K filed with the Securities and Exchange Commission (the “SEC”) on April 7, 2016).
3.2	Restated Articles of Organization of Western New England Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of the Form 8-K filed with the SEC on October 26, 2016).
3.3	Amended and Restated Bylaws of Western New England Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of the Form 8-K filed with the SEC on February 2, 2017).
4.1	Form of Stock Certificate of Western New England Bancorp, Inc. (f/k/a Westfield Financial, Inc.) (incorporated by reference to Exhibit 4.1 of the Registration Statement No. 333-137024 on Form S-1 filed with the SEC on August 31, 2006).
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101**	Financial statements from the quarterly report on Form 10-Q of Western New England Bancorp, Inc. for the quarter ended September 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Net Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Shareholders’ Equity, (v) the Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements.

* Filed herewith.

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on November 7, 2018.

Western New England Bancorp, Inc.

By: /s/ James C. Hagan
James C. Hagan
President and Chief Executive Officer

By: /s/ Guida R. Sajdak
Guida R. Sajdak
Executive Vice President and Chief Financial Officer

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Section 2: EX-31.1 (CERTIFICATION OF CHIEF EXECUTIVE OFFICER)

Western New England Bancorp, Inc. 10-Q

EXHIBIT 31.1

CERTIFICATION

I, James C. Hagan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Western New England Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2018

/s/ James C. Hagan
James C. Hagan
President and Chief Executive Officer
(Principal Executive Officer)

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Section 3: EX-31.2 (CERTIFICATION OF CHIEF FINANCIAL OFFICER)

Western New England Bancorp, Inc. 10-Q

EXHIBIT 31.2

CERTIFICATION

I, Guida R. Sajdak, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Western New England Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2018

/s/ Guida R. Sajdak
Guida R. Sajdak
Chief Financial Officer

(Principal Financial Officer)

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Section 4: EX-32.1 (CERTIFICATION OF CHIEF EXECUTIVE OFFICER)

Western New England Bancorp, Inc. 10-Q

EXHIBIT 32.1

STATEMENT FURNISHED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002, 18 U.S.C. SECTION 1350

In connection with the Quarterly Report on Form 10-Q of Western New England Bancorp, Inc. (the "Company") for the quarter ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), James C. Hagan, President and Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

A) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), and

B) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods covered by the Report.

November 7, 2018	/s/ James C. Hagan
Dated	James C. Hagan
	President and Chief Executive Officer

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Section 5: EX-32.2 (CERTIFICATION OF CHIEF FINANCIAL OFFICER)

Western New England Bancorp, Inc. 10-Q

EXHIBIT 32.2

STATEMENT FURNISHED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002, 18 U.S.C. SECTION 1350

In connection with the Quarterly Report on Form 10-Q of Western New England Bancorp, Inc. (the "Company") for the quarter ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Guida R. Sajdak, Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

A) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), and

B) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods covered by the Report.

November 7, 2018	/s/ Guida R. Sajdak
Dated	Guida R. Sajdak
	Chief Financial Officer

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