TRUSTCO BANK CORP N Y
Form 10-K
March 03, 2017

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

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2016
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 0-10592

TRUSTCO BANK CORP NY
(Exact name of registrant as specified in its charter)

NEW YORK	14-1630287
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5 SARNOWSKI DRIVE, GLENVILLE, NEW YORK 12302
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (518) 377-3311

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

Title of each class	Name of exchange on which registered)
Common Stock, $1.00 Par Value	The NASDAQ Global Select Market

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes. No.

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

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller reporting company

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

The aggregate market value of the common stock held by non-affiliates as of June 30, 2016 was approximately $591,961,513 (based upon the closing price of $6.41 on June 30, 2016, as reported on the NASDAQ Global Select Market).

The number of shares outstanding of the registrant's common stock as of March 1, 2017 was 95,862,943.

Documents Incorporated by Reference: Portions of registrant's Proxy Statement filed for its 2017 Annual Meeting of Shareholders to be filed within 120 days of the registrant's fiscal year end.

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USE OF NON-GAAP FINANCIAL MEASURES

The Securities and Exchange Commission ("SEC") has adopted certain rules with respect to the use of "non-GAAP financial measures" by companies with a class of securities registered under the Securities Exchange Act of 1934, such as TrustCo. GAAP is generally accepted accounting principles in the United States of America. Under the SEC rules, companies making disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure and a statement of the company's reasons for utilizing the non-GAAP financial measure as part of its financial disclosures.

A discussion of certain non-GAAP financial measures, including taxable equivalent net interest income and net interest margin and efficiency ratio, used in this report and in the Annual Report to Shareholders included as Exhibit 13 to this Form 10-K, as well as a reconciliation of these measures to the closest comparable GAAP financial measures, is set forth in the Annual Report to Shareholders included as Exhibit 13 to this Form 10-K and is incorporated herein by reference.

PART I

Item 1. Business

General

TrustCo Bank Corp NY ("TrustCo" or the "Company") is a savings and loan holding company having its principal place of business at 5 Sarnowski Drive, Glenville, New York 12302. TrustCo was incorporated under the laws of New York in 1981 to be the parent holding company of The Schenectady Trust Company, which subsequently was renamed to Trustco Bank New York and, later, to Trustco Bank, National Association. The Company's principal subsidiary, Trustco Bank (also referred to as the "Bank"), is the successor by merger to Trustco Bank, National Association.

Through policy and practice, TrustCo continues to emphasize that it is an equal opportunity employer. There were 808 full-time equivalent employees of TrustCo at year-end 2016. TrustCo had 12,203 shareholders of record as of December 31, 2016 and the closing price of the TrustCo common stock on that date was $8.75.

Subsidiaries

Trustco Bank

Trustco Bank is a federal savings bank engaged in providing general banking services to individuals, partnerships, and corporations. At year-end 2016, the Bank operated 157 automatic teller machines and 145 banking offices in Albany, Columbia, Dutchess, Greene, Montgomery, Orange, Rensselaer, Rockland, Saratoga, Schenectady, Schoharie, Ulster, Warren, Washington and Westchester counties of New York, Brevard, Charlotte, Hillsborough, Lake, Manatee, Martin, Orange, Osceola, Palm Beach, Polk, Sarasota, Seminole, and Volusia counties in Florida, Bennington County in Vermont, Berkshire County in Massachusetts and Bergen County in New Jersey. The largest part of such business consists of accepting deposits and making loans and investments. The Bank provides a wide range of both personal and business banking services. The Bank is supervised and regulated by the federal Office of the Comptroller of the Currency ("OCC") and is a member of the Federal Reserve System. Its deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") to the extent permitted by law. The Bank's subsidiary, Trustco Realty Corp., is a real estate investment trust (or "REIT") that was formed to acquire, hold and manage real estate mortgage assets, including residential mortgage loans and mortgage backed securities. The income earned on these assets, net of expenses, is distributed in the form of dividends. Under current New York State tax law, 60% of the dividends received by the Bank from Trustco Realty Corp. are excluded from total taxable income for New York State income tax purposes. The

Bank accounted for substantially all of TrustCo's 2016 consolidated net income and average assets. The Bank's other active subsidiaries, Trustco Insurance Agency, Inc. and ORE Property, Inc., did not engage in any significant business activities during 2016 and 2015. On July 21, 2015 Trustco Bank, entered into a formal agreement with the OCC. The agreement relates to the findings of the OCC following an examination of the Bank; additional information regarding the agreement is contained in TrustCo's Annual Report to Shareholders for the year ended December 31, 2016, which is filed as Exhibit 13 hereto and incorporated herein by reference, under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations, and in the accompanying consolidated financial statements and the notes thereto.

Trustco Financial Services, the name under which Trustco Bank's trust department operates, serves as executor of estates and trustee of personal trusts, provides asset and wealth management services, provides estate planning and related advice, provides custodial services, and acts as trustee for various types of employee benefit plans and corporate pension and profit sharing trusts. The aggregate market value of the assets under trust, custody, or management of the trust department of the Bank was approximately $845.7 million as of December 31, 2016.

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The daily operations of the Bank remain the responsibility of its officers, subject to the oversight of its Board of Directors and overall supervision by TrustCo. The activities of the Bank are included in TrustCo's consolidated financial statements.

ORE Subsidiary Corp.

In 1993, TrustCo created ORE Subsidiary Corp., a New York corporation, to hold and manage certain foreclosed properties acquired by the Bank. The accounts of this subsidiary are included in TrustCo's consolidated financial statements.

Competition

TrustCo faces strong competition in its market areas, both in attracting deposits and making loans. The Company's most direct competition for deposits, historically, has come from commercial banks, savings associations, and credit unions that are located or have branches in the Bank's market areas. The competition ranges from other locally based commercial banks, savings banks and credit unions to branch offices of the largest financial institutions in the United States. In its principal market areas, the Capital District area of New York State and Central Florida, TrustCo's principal competitors are local branch operations of super-regional banks, branch offices of money center banks, and locally based commercial banks and savings institutions. The Bank is the largest depository institution headquartered in the Capital District area of New York State. The Company also faces competition for deposits from national brokerage houses, short-term money market funds, and other corporate and government securities mutual funds.

Factors affecting the acquisition of deposits include pricing, office locations and hours of operation, the variety of deposit accounts offered, and the quality of customer service provided. While loan demand has moderated over the last several years, competition for loans has remained strong. Commercial banks, savings institutions, traditional mortgage brokers affiliated with local offices and nationally franchised real estate brokers are all active and aggressive competitors. The Company competes in this environment by providing a full range of financial services based on a tradition of financial strength and integrity dating from its inception. The Company competes for loans principally through the interest rates and loan fees it charges and the efficiency and quality of services it provides to borrowers.

Supervision and Regulation

Banking is a highly regulated industry, with numerous federal and state laws and regulations governing the organization and operation of banks and their affiliates. As a savings and loan holding company, TrustCo and its non-bank subsidiaries are supervised and regulated by the Board of Governors of the Federal Reserve System ("Federal Reserve Board"). The OCC is the Bank's primary federal regulator and supervises and examines the Bank. Under the Home Owners' Loan Act of 1934 and OCC regulations, Trustco Bank must obtain prior OCC approval for acquisitions, and its business operations and activities are restricted. Because the FDIC provides deposit insurance to the Bank, the Bank is also subject to its supervision and regulation even though the FDIC is not the Bank's primary federal regulator.

The following summary of laws and regulations applicable to the Company or the Bank is not intended to be a complete description of those laws and regulations or their effects on the Company and the Bank, and it is qualified in its entirety by reference to the particular statutory and regulatory provisions described.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was enacted in July 2010 and has created, and will likely continue to create, dramatic changes across the financial regulatory system. Implementation of the Dodd-Frank Act required many new rules to be made by various federal regulatory agencies,

including TrustCo's and the Bank's regulatory agencies, and the effect of many of the Dodd-Frank Act's provisions has been, and will continue to be, determined through the rulemaking process. Further, President Trump and the Congressional majority have indicated that the Dodd-Frank Act will be under further scrutiny and that some of the provisions of the Dodd-Frank Act and the rules promulgated thereunder may be revised, repealed, or amended. We cannot predict the ultimate effect of the Dodd-Frank Act, or any changes to it or its implementing rules, on TrustCo or the Bank at this time, including the extent to which the act or changes to it could affect costs, our ability to efficiently pursue business opportunities, or our business, financial condition or results of operations.

The Dodd-Frank Act included provisions that, among other effects, created a new agency, the Consumer Financial Protection Bureau (the "CFPB"), to centralize responsibility for consumer financial protection and be responsible for implementing, examining and enforcing compliance with major federal consumer financial laws, imposed new consumer protection requirements in mortgage loan transactions and increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor.

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Dividends

Most of TrustCo's revenues consist of cash dividends paid to TrustCo by the Bank, payment of which is subject to various regulatory limitations. The payment of dividends by the Bank to TrustCo is subject to continued compliance with minimum regulatory capital requirements, the Bank's compliance with the capital plan required under the terms of the Bank's July 21, 2015 formal agreement with the OCC, and the receipt of regulatory approval (or non-objection) from the Bank's and the Company's regulators. Under the agreement with the OCC, the Bank may declare or pay a dividend or make a capital distribution only (a) when the Bank is in compliance with its approved written capital plan, and would remain in compliance with such Capital Plan immediately following the declaration or payment of any dividend or capital distribution and (b) following OCC approval under OCC capital distribution rules.

OCC regulations impose limitations upon all capital distributions by the Bank, including cash dividends, payments to repurchase Bank stock, and payments to stockholders of another institution in a cash-out merger. Under the regulations, an application to and the approval of the OCC is required prior to any capital distribution if the institution does not meet the criteria for "expedited treatment" of applications under OCC regulations (generally, examination ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the OCC. If an application is not required, the institution must still provide prior notice to the OCC and the Federal Reserve Board of the capital distribution if, like the Bank, it is a subsidiary of a holding company. The OCC may disapprove a dividend if the institution would be undercapitalized following the distribution, the proposed capital distribution raises safety and soundness concerns, or the capital distribution would violate a prohibition contained in any statue, regulation or agreement between the bank and a regulator or a condition imposed in a previously approved application or notice.

As noted above, a savings institution, such as the Bank, that is a subsidiary of a savings and loan holding company and that proposes to make a capital distribution must also submit written notice to the Federal Reserve Board prior to such distribution, and Federal Reserve Board may object to the distribution based on safety and soundness or other concerns. The Federal Reserve Board has stated that it expects to issue regulations implementing review standards for dividend notices and that the applicable regulation will provide that a dividend notice may be denied by the Federal Reserve Board if following the dividend, the savings association will be less than adequately capitalized, the proposed dividend raises safety or soundness concerns or the proposed dividend violates a prohibition contained in any statute, regulation, enforcement action or agreement between the thrift or holding company and an appropriate federal banking agency, a condition imposed on the savings association or holding company in an application or notice approved by an appropriate federal banking agency or any formal or informal enforcement action involving the savings association or holding company.

Compliance with regulatory standards regarding capital distributions could also limit the amount of dividends that TrustCo may pay to its shareholders.

See Note 14 to the consolidated financial statements contained in TrustCo's Annual Report to Shareholders for the year ended December 31, 2016 for information concerning the Bank's regulatory capital requirements.

Regulatory Capital Requirements and Prompt Corrective Action.

Regulatory Capital Rules. The Company and the Bank are subject to regulatory capital requirements. In July 2013, the Federal Reserve Board, FDIC and OCC published final rules establishing a new comprehensive capital framework for all U.S. banking organizations that were designed to implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. The new rules were effective for the Company and the Bank on January 1, 2015, with full compliance with all of the final rule's requirements being phased in over a multi-year schedule. Calendar year

2016 was the second year of implementation of the new capital rules. Prior to January 2015, the Company was not subject to consolidated regulatory capital requirements.

The new capital rules, among other things, introduced a new capital measure, "Common Equity Tier 1" ("CET1"). CET1 capital is generally defined as common stock instruments that meet the eligibility criteria in the final capital rule (generally, instruments representing the most subordinated claim upon liquidation, having no maturity date and being redeemable via discretionary purchases only with regulatory approval, not being subject to any expectations that the stock will be repurchased, redeemed or cancelled and not being secured by the banking organization or any related entity), retained earnings, accumulated other comprehensive income and common equity Tier 1 minority interests, subject to certain limitations. Tier 1 capital for the Company and the Bank consists of CET1 capital plus "additional Tier 1 capital," which generally includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Also under the capital rules, total capital includes Tier 1 capital and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of accumulated other comprehensive income ("AOCI"), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into common equity Tier 1 capital (including unrealized gains and losses on available-for-sale-securities). The Company has made this opt-out election. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

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The new capital rules also increased the Tier 1 capital ratio requirement, changed the total assets utilized in the Tier 1 leverage ratio calculation from total assets at quarter end to average total assets during the quarter, changed the risk-weightings of certain assets for purposes of risk-based capital ratios, created an additional “capital conservation buffer” over the required capital ratios, and changed what qualifies as capital for purposes of meeting the various capital requirements.

Under the new capital rules, the minimum capital ratios, which took effect January 1, 2015, are:

·4.5% CET1 to risk-weighted assets;

·6.0% Tier 1 capital to risk-weighted assets;

·8.0% Total capital to risk-weighted assets; and

·4% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (the “leverage ratio”).

At December 31, 2016, the Bank had a Tier 1 leverage ratio (Tier 1 capital to total average consolidated assets) of 8.83, CET1 capital ratio (CET1 capital to risk-weighted assets) of 17.24, a Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) of 17.24, and a total capital ratio (total capital to risk-weighted assets) of 18.49. Also at December 31, 2016, the Company had a Tier 1 leverage ratio (Tier 1 capital to total average consolidated assets) of 9.11, CET1 capital ratio (CET1 capital to risk-weighted assets) of 17.78, a Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) of 17.78, and a total capital ratio (total capital to risk-weighted assets) of 19.04.

As noted above, the new capital rules require the Company’s and the Bank’s capital to exceed the regulatory standards plus a capital conservation buffer in order to avoid constraints on dividends, equity repurchases and certain compensation. To meet the requirement when it is fully phased in, the organization must maintain an amount of CET1 capital that exceeds the buffer level of 2.5% above each of the minimum risk-weighted asset ratios. The requirement is being phased in over a four-year period, which started January 1, 2016, when the amount of such capital was required to exceed the buffer level of 0.625%. The buffer level to 1.25% as of January 1, 2017, and will increase by 0.625% each year until it reaches 2.5% on January 1, 2019. When the capital conservation buffer requirement is fully phased in, to avoid constraints, a banking organization must maintain the following capital ratios: (1) CET1 to risk-weighted assets of more than 7.0%, (ii) Tier 1 capital to risk-weighted assets of more than 8.5%, and (iii) total capital (Tier 1 plus Tier 2) to risk-weighted assets of more than 10.5%.

As of December 31, 2016, the minimum capital ratios including the capital conservation buffer are:

·5.125% CET1 to risk-weighted assets;

·6.625% Tier 1 capital to risk-weighted assets;

·8.625% Total capital to risk-weighted assets; and

·4% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (the “leverage ratio”).

The OCC has the ability to establish an individual minimum capital requirement for a particular institution, which varies from the capital levels that would otherwise be required under the capital regulations, based on such factors as concentrations of credit risk, levels of interest rate risk, and the risks of non-traditional activities as well as others. The OCC has not imposed any such requirement on the Bank.

The new capital rules modify the calculation of risk-weighted assets, although they generally continue the treatment of residential mortgages under the prior rules. Under the rules, a bank may assign a 50% risk weight to a first-lien residential mortgage exposure that:

- Is secured by property that is owner-occupied or rented,

- Is made in accordance with “prudent underwriting standards,” including loan-to-value ratios,

- Is not 90 days or more past due or in nonaccrual status, and

- Is not restructured or modified.

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Other first-lien residential exposures, as well as junior-lien exposures if the bank does not hold the first lien, are assigned a 100% risk weight.

The exposure amount for on-balance sheet assets is generally the carrying value of the exposure as determined under GAAP. If a banking organization has elected to opt out of the accumulated other comprehensive income provisions discussed above, the exposure amount for available for sale or held-to-maturity debt securities is the carrying value (including accrued but unpaid interest and fees) of the exposure, less any net unrealized gains plus any unrealized losses. Further, the new rules retain the prior risk-weighting rules for exposures to debt directly and unconditionally guaranteed by the U.S. federal government and its agencies. Such exposures receive a 0% risk weight. Exposures conditionally guaranteed by the federal government, Federal Reserve Board or a federal government agency would receive a 20% risk weight. Further, the capital rules assign a 20% risk weight to non-equity exposures to government-sponsored entities (“GSEs”) and a 100% risk weight to preferred stock issued by a GSE. The new rules define a GSE as an entity established or chartered by the federal government to serve public purposes but whose debt obligations are not “explicitly guaranteed” by the full faith and credit of the federal government. Banking organizations must assign a 20% risk weight to general obligations of a public sector entity (for example, a state, local authority or other governmental subdivision below the sovereign level) that is organized under U.S. law and a 50% risk weight for a revenue obligation of such an entity.

Prompt Corrective Action. Federal banking regulations also establish a “prompt corrective action” capital framework for the classification of insured depository institutions, such as Trustco Bank, into five categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The federal banking agencies are required to take certain supervisory actions (and may take additional discretionary actions) with respect to an undercapitalized institution or its holding company. Such actions could have a direct material effect on an institution’s or its holding company’s financial condition and activities. Under the prompt corrective action rules currently in effect, an institution is deemed to be (a) ”well-capitalized” if it has total risk-based capital of 10.0% or more, has a Tier 1 risk-based capital ratio of 8.0% or more, has a CET1 risk based capital ratio of 6.5% or more, and has leverage capital ratio of 5.0% or more and is not subject to any order or final capital directive to meet and maintain a specific capital level for any capital measure; (b) ”adequately capitalized” if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 6.0% or more, a CET1 risk based capital ratio of 4.5% or more and has a leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well-capitalized; (c) ”undercapitalized” if it has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio that is less than 6.0%, a CET1 capital ratio less than 4.5% or a Tier 1 leverage capital ratio that is less than 4.0%; (d) ”significantly undercapitalized” if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 4.0%, a CET1 capital ratio less than 3% or a Tier 1 leverage capital ratio that is less than 3.0%; and (e) ”critically undercapitalized” if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. In certain situations, a federal banking agency may reclassify a well-capitalized institution as adequately capitalized and may require an adequately capitalized or undercapitalized institution to comply with supervisory actions as if the institution were in the next lower category.

A depository institution is generally prohibited from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be undercapitalized. Undercapitalized institutions also are subject to growth limitations and are required to submit a capital restoration plan to the regulatory agencies. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. In addition, for a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution’s total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan,

it is treated as if it is “significantly undercapitalized.”

“Significantly undercapitalized” depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become “adequately capitalized,” requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. “Critically undercapitalized” institutions are subject to the appointment of a receiver or conservator.

At December 31, 2016 and 2015, each of TrustCo and Trustco Bank met all capital adequacy requirements to which it was subject under the OCC and FRB regulations.

Holding Company Activities

The activities of savings and loan holding companies are governed, and limited, by the Home Owners’ Loan Act and the Federal Reserve Board’s regulations. In general, TrustCo’s activities are limited to those permissible for “multiple” savings and loan holding companies (that is, savings and loan holding companies owning more than one savings association subsidiary) as of March 5, 1987, activities permitted for bank holding companies as of November 12, 1999, and activities permissible for “financial holding companies” (which are described below). Activities permitted to multiple savings and loan holding companies include certain real estate investment activities, and other activities permitted to bank holding companies under the Bank Holding Company Act. Activities permissible for a financial holding company are those considered financial in nature (including securities and insurance activities) or those incidental or complementary to financial activities.

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A savings and loan holding company is prohibited from, directly or indirectly, acquiring more than 5% of the voting stock of another financial institution or savings and loan holding company without the prior written approval of the Federal Reserve Board. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board considers the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the deposit insurance fund, the convenience and needs of the community and competitive factors.

The Federal Reserve may not approve any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Beginning in 2015, TrustCo became subject to formal regulatory capital requirements and is now obligated to hold capital in the same amount and type that is required for insured depository institutions such as the Bank. Please refer to the discussion above under “Regulatory Capital Requirements and Prompt Corrective Action -- New Regulatory Capital Rules.”

In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the Federal Reserve Board, and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution. The Dodd-Frank Act, moreover, codifies the Federal Reserve’s long-standing “source of strength” doctrine and thus requires that bank or thrift holding companies serve as a source of financial strength for their depository institution subsidiaries. The phrase “source of financial strength” is defined in the Dodd-Frank Act as “the ability of a company that directly or indirectly owns or controls an insured depository institution to provide financial assistance to such insured depository institution in the event of the financial distress of the insured depository institution.” The federal banking agencies are authorized to adopt regulations with respect to this requirement, although they have not yet done so.

Securities Regulation and Corporate Governance

The Company’s common stock is registered with the SEC under Section 12(b) of the Securities Exchange Act of 1934, and the Company is subject to restrictions, reporting requirements and review procedures under federal securities laws and regulations. The Company is also subject to the rules and reporting requirements of The Nasdaq Stock Market LLC, on which its common stock is traded.

Like other issuers of publicly traded securities, the Company must also comply with provisions of the Dodd-Frank Act that require publicly traded companies to give stockholders a non-binding vote on executive compensation, and the Company will also be subject to the Dodd-Frank Act provisions that authorize the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company’s proxy materials.

Further, the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) implemented legislative reforms intended to address corporate and accounting fraud and contained reforms of various business practices and numerous aspects of corporate governance. For example, Sarbanes-Oxley addresses accounting oversight and corporate governance matters, including the creation of a five-member oversight board appointed by the Securities and Exchange Commission to set and enforce auditing, quality control and independence standards for accountants and have investigative and disciplinary powers; increased responsibilities and codified requirements relating to audit committees of public companies and how they interact with a company’s public accounting firm; the prohibition of accounting firms from providing various types of consulting services to public clients and requiring accounting firms to rotate partners among public client assignments every five years; expanded disclosure of corporate operations and internal controls and certification by chief executive officers and chief financial officers to the accuracy of periodic reports filed with

the SEC; and prohibitions on public company insiders from trading during retirement plan “blackout” periods, restrictions on loans to company executives and enhanced controls on and reporting of insider trading.

Although the Company has and will continue to incur additional expense in complying with the corporate governance provisions of the Dodd-Frank Act and Sarbanes-Oxley and the resulting regulations, management does not expect that such compliance will have a material impact on the Company’s financial condition or results of operations.

Federal Savings Institution Regulation

Business Activities. Federal law and regulations govern the activities of federal savings banks such as the Bank. These laws and regulations delineate the nature and extent of the activities in which federal savings banks may engage. In particular, certain lending authority for federal savings banks, e.g., commercial, non-residential real property loans and consumer loans, is limited to a specified percentage of the institution’s capital or assets.

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Insurance of Deposit Accounts. Deposits of Trustco Bank are insured by the Deposit Insurance Fund ("DIF") of the FDIC, and the Bank is subject to deposit insurance assessments to maintain the DIF. The FDIC determines insurance premiums based on a number of factors, primarily the risk of loss that insured institutions pose to the DIF. Deposit insurance assessments are based on average consolidated total assets minus average tangible equity. Under the FDIC's risk-based assessment system, as revised effective July 1, 2016, insured institutions with less than $10 billion in assets, such as the Bank, are assigned to one of three categories based on their composite examination ratings, with higher-rated, less risky institutions paying lower assessments. A range of initial base assessment rates applies to each category, adjusted downward based on unsecured debt issued by the institution to produce total base assessment rates. Total base assessment rates currently range from 1.5 to 16 basis points banks in the least risky category to 11 to 30 basis points for banks in the most risky category, all subject to further adjustment upward if the institution holds more than a limited amount of unsecured debt issued by another FDIC-insured institution.

The FDIC has the authority to raise or lower assessment rates, subject to limits, and to impose special additional assessments. The Dodd-Frank Act eliminated the previous statutory maximum limit on the FDIC's reserve ratio (which is generally the ratio of the DIF balance to the estimated amount of deposits insured by the DIF) and set the minimum reserve ratio to not less than 1.35% of estimated insured deposits or the comparable percentage of the FDIC's assessment base. The act also required the FDIC to take the steps necessary to attain the 1.35 percent ratio by September 30, 2020, subject to an offsetting requirement for certain institutions.

FDIC deposit insurance expense totaled $4.7 million, $5.0 million, and $2.6 million in 2016, 2015, and 2014, respectively. FDIC deposit insurance expense includes deposit insurance assessments and Financing Corporation ("FICO") assessments related to outstanding bonds issued by FICO in the late 1980s to recapitalize the now defunct Federal Savings & Loan Insurance Corporation. The FICO assessments will continue until the bonds mature in 2017 to 2019.

Future changes in insurance premiums could have an adverse effect on the operating expenses and results of operations of Trustco Bank, and the Bank cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OCC. The Bank does not know of any practice, condition or violation that might lead to termination of its deposit insurance.

Assessments. The Bank is required to pay assessments to the OCC to fund the agency's operations. The general assessments, paid on a semi-annual basis, is computed upon the Bank's total assets, including consolidated subsidiaries, as reported in the Bank's latest quarterly financial report. The OCC's assessment schedule includes a surcharge for institutions that require increased supervisory resources. The assessments paid by the Bank for the year ended December 31, 2016 totaled approximately $1.3 million.

Community Reinvestment Act. The Community Reinvestment Act ("CRA") requires each savings institution, as well as commercial banks and certain other lenders, to identify the communities served by the institution's offices and to identify the types of credit the institution is prepared to extend within those communities. The CRA also requires the OCC to assess an institution's performance in meeting the credit needs of its identified communities as part of its examination of the institution, and to take such assessments into consideration in reviewing applications with respect to branches, mergers and other business combinations, including acquisitions by savings and loan holding companies. An unsatisfactory CRA rating may be the basis for denying such an application and community groups have successfully protested applications on CRA grounds. In connection with its assessment of CRA performance, the OCC assigns CRA ratings of "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance." The Bank was rated "satisfactory" in its last CRA examination. Institutions are evaluated based on (i) its record of helping to meet the credit needs of its assessment area through lending activities; (ii) its qualified investments; and (iii) the availability and

effectiveness of the institution's system for delivering retail banking services. An institution that is found to be deficient in its performance in meeting its community's credit needs may be subject to enforcement actions, including cease and desist orders and civil money penalties.

Qualified Thrift Lender Test. As a savings institution regulated by the OCC, the Bank must be a "qualified thrift lender" under either the Qualified Thrift Lender ("QTL") test under the Home Owners' Loan Act or the Internal Revenue Code's Domestic Building and Loan Association ("DBLA") test to avoid certain restrictions on its and the Company's operations and activities. A savings institution may use either test to qualify and may switch from one test to the other; however, the institution must meet the time requirements of the respective test, that is, nine out of the preceding 12 months for the QTL test and at the close of the taxable year for the DBLA test.

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Under the QTL test, the savings institution must hold qualified thrift investments equal to at least 65% of the institution's portfolio assets. The savings institution's actual thrift investment percentage is the ratio of its qualified thrift investments divided by its portfolio assets. Portfolio assets are total assets minus goodwill and other intangible assets, office property, and liquid assets not exceeding 20% of total assets. An institution ceases to meet the QTL test when its actual thrift investment percentage falls below 65% of portfolio assets for four months within any 12-month period. To be a qualified thrift lender under the DBLA test, a savings association must meet a "business operations test" and a "60% of assets test." The business operations test requires the business of a DBLA to consist primarily of acquiring the savings of the public and investing in loans. An institution meets the public savings requirement when it meets one of two conditions: (i) the institution acquires its savings accounts in conformity with OCC rules and regulations and (ii) the general public holds more than 75% of its deposits, withdrawable shares, and other obligations. An institution meets the investing in loans requirement when more than 75% of its gross income consists of interest on loans and government obligations, and various other specified types of operating income that financial institutions ordinarily earn. The 60% of assets test requires that at least 60% of a DBLA's assets must consist of assets that thrifts normally hold, except for consumer loans that are not educational loans.

These are significant consequences for failing the QTL Test, including activities limitations and branching restrictions. In addition, an institution that fails the QTL test would be prohibited from paying dividends, except under circumstances that are permissible for a national bank, that are necessary to meet the obligations of the institution's holding company, and that are specifically approved by both the OCC and Federal Reserve Bank after a written request submitted by the thrift at least 30 days in advance of the proposed payment. Finally, failure of the QTL Test will subject the institution to enforcement action. If the Bank fails the qualified thrift lender test, within one year of such failure the Company must register as, and will become subject to, the activities restrictions applicable to bank holding companies, unless the Bank requalifies within the year. The activities authorized for a bank holding company are generally more limited than are the activities authorized for a savings and loan holding company. If the Bank fails the test a second time, the Company must immediately register as, and become subject to, the restrictions applicable to a bank holding company. The Bank is currently, and expects to remain, in compliance with the qualified thrift lender test.

Transactions with Related Parties. The Bank's transactions with "affiliates" (generally, any company that controls or is under common control with the Bank, including TrustCo) is limited by Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve's implementing Regulation W. Under these laws, the aggregate amount of "covered transactions" between the Bank and any one affiliate is limited to 10% of the Bank's capital stock and surplus, and the aggregate amount of covered transactions by the Bank with all of its affiliates is limited to 20% of capital stock and surplus. Certain covered transactions (primarily credit-related transactions) are required to be secured by collateral in an amount and of a type described in Section 23A and Regulation W. Transactions by the Bank with its affiliates must be on terms and under circumstances that are at least as favorable to the Bank as those prevailing at the time for comparable transactions with non-affiliates. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies, and no savings institution may purchase the securities of any affiliate other than a subsidiary.

The definition of "covered transactions" as used in Section 23A includes credit exposure on derivatives transactions and securities lending and borrowing transactions, as well as the acceptance of affiliate-issued debt obligations as collateral for a loan or an extension of credit. The Dodd-Frank Act revised Section 23A to require that collateral must be maintained at all times for covered transactions, rather than only at the time of the transaction, and restricted the use of debt obligations issued by an affiliate to satisfy collateral obligations. Finally, the Dodd-Frank Act also authorizes the OCC (with respect to federal savings associations such as the Bank), in conjunction with the Federal Reserve, to grant exemptions under Section 23A, subject to the FDIC's determination (or non-objection within a 60-day notice period) that the exemption does not present an unacceptable risk to the DIF.

The Bank also is restricted in its ability to extend credit to its directors, executive officers and 10% shareholders, as well as to entities controlled by such persons. Extensions of credit to those insiders must be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons; may not involve more than the normal risk of repayment or present other unfavorable features and may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate. In addition, extensions of credit in excess of certain limits must be approved by the Bank's Board of Directors.

Certain non-credit transactions between an insured depository institution and its insiders, such as asset purchase and sales, are prohibited unless the transaction is on market terms and, if the transaction represents more than 10% of the capital stock and surplus of the institution, has been approved in advance by a majority of the disinterested members of the board of directors of the institution. The Dodd-Frank Act also imposed new limits on loans to insiders with respect to derivatives transactions, repurchase and reverse-repurchase agreements and securities lending and borrowing transactions.

Safety and Soundness Regulations. The federal banking agencies (including the OCC) have adopted certain safety and soundness standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and internal audit systems; loan documentation; credit underwriting; interest rate risk exposure; asset growth; asset quality; earnings and compensation, fees and benefits, as well as other operational and managerial standards as the agency deems appropriate. Interagency Guidelines Establishing Standards for Safety and Soundness set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency (the OCC in the case of the Bank) determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

Enforcement. The Federal Reserve and the OCC have extensive enforcement authority over savings institutions and their holding companies, including the Bank and TrustCo. This includes enforcement authority with respect to the actions of the Bank's and TrustCo's directors, officers and other "institution-affiliated parties," including attorneys and auditors. This enforcement authority also includes, among other things, the ability to assess civil money penalties, issue cease-and-desist or removal orders and initiate injunctive actions. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Public disclosure of final enforcement actions by the OCC and the Federal Reserve is required.

Institutions in Troubled Condition. Certain events, including entering into a formal written agreement with a bank's regulator or being informed by the regulator that the bank is in troubled condition, will require that a bank give prior notice to their primary regulator before adding or replacing any member of the board of directors, employing any person as a senior executive officer, or changing the responsibilities of any senior executive officer so that the person would assume a different senior executive position. Troubled condition banks are prohibited from making, or agreeing to make, certain "golden parachute payments" to institution affiliated parties, subject to certain exceptions.

Consumer Laws and Regulations. In addition to the other laws and regulations discussed above, the Bank is subject to consumer laws and regulations designed to protect consumers in transactions with financial institutions. These laws and regulations include, among others, the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act and the Real Estate Settlement Procedures Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits from, making loans to, or engaging in other types of transactions with, such customers.

The CFPB has adopted rules related to mortgage loan origination and mortgage loan servicing. In particular, the CFPB has issued a rule implementing the ability-to-repay and qualified mortgage ("QM") provisions of the Truth in Lending Act, as amended by the Dodd-Frank Act (the "QM Rule"). The ability-to-repay provision requires creditors to make reasonable, good faith determinations that borrowers are able to repay their mortgages before extending the credit based on a number of factors and consideration of financial information about the borrower from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of "qualified mortgage" are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for prime loans meeting the QM requirements, and a rebuttable presumption for higher-priced/subprime loans meeting the QM requirements. The definition of a "qualified mortgage" incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43% debt-to-income ratio for borrowers if the loan is to meet the QM definition, though some mortgages that meet GSE, FHA and VA underwriting guidelines may, for a period not to exceed seven years, meet the QM definition without being subject to the 43% debt-to-income limits. The QM Rule became effective in January 2014.

Anti-Money Laundering and Customer Identification. The Bank is subject to extensive anti-money laundering provisions and requirements, which generally require that it implement a comprehensive customer identification program and an anti-money laundering program and procedures. All financial institutions, including the Company and the Bank, are required to take certain measures to identify their customers, prevent money laundering, monitor certain customer transactions and report suspicious activity to U.S. law enforcement agencies, and scrutinize or prohibit altogether certain transactions of special concern. Financial institutions also are required to respond to requests for information from federal banking regulatory agencies and law enforcement agencies concerning their customers and their transactions. Information-sharing among financial institutions concerning terrorist or money laundering activities is encouraged by an exemption provided from the privacy provisions of the GLB Act (described below) and other laws. Further, the effectiveness of a financial institution in combating money laundering activities is a factor to be considered in applications submitted by a financial institution for merger or acquisition proposals. The Company has in place a Bank Secrecy Act compliance program, and it engages in very few transactions of any kind with foreign

financial institutions or foreign persons.

Consumer Privacy. The Gramm-Leach-Bliley Act of 1999 (the "GLB Act") generally provided for sweeping financial modernization for commercial banks, savings banks, securities firms, insurance companies, and other financial institutions operating in the United States. Among other matters, the GLB Act established a federal rule regarding the confidential treatment of nonpublic personal information about consumers. These provisions of the GLB Act require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy rules affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. Because the Company does not sell customer information or give customer information to outside third parties or its affiliates except under limited circumstances (e.g., providing customer information to the Company's data processing provider), the rules have not had a significant impact on the Company's results of operations or financial condition.

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Federal Reserve System

Federal Reserve Board regulations require savings institutions to maintain reserves against their transaction accounts. The reserve for transaction accounts effective as of January 19, 2017 was as follows:

Amount of transaction accounts	Reserve Requirement
$0 to $15.5 million	0% of amount.
Over $15.5 million and up to $115.1 million	3% of amount.
Over $115.1 million	10% of amount over $115.1 million

The Bank is in compliance with these requirements.

Federal Home Loan Bank of New York. The Bank is a member of Federal Home Loan Bank ("FHLB") of New York, which is one of 11 regional FHLBs that serve as reserve or central banks for their members. The FHLBs are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system and makes loans or advances to members. The Bank is also required to purchase and maintain stock in the FHLB of New York at or above levels specified in the FHLB of New York capital plan. As of December 31, 2016, the Bank owned $5.5 million in FHLB of New York stock, which was in compliance with its obligations.

Foreign Operations

Neither TrustCo nor the Bank engage in any operations in foreign countries or have outstanding loans to foreign debtors.

Statistical Information Analysis

The "Management's Discussion and Analysis of Financial Condition and Results of Operations" are included in TrustCo's Annual Report to Shareholders for the year ended December 31, 2016, which contains a presentation and discussion of statistical data relating to TrustCo, is hereby incorporated by reference. This information should not be construed to imply any conclusion on the part of the management of TrustCo that the results, causes, or trends indicated therein will continue in the future. The nature and effects of governmental monetary policy, supervision and regulation, future legislation, inflation and other economic conditions and many other factors which affect interest rates, investments, loans, deposits, and other aspects of TrustCo's operations are extremely complex and could make historical operations, earnings, assets, and liabilities not indicative of what may occur in the future.

Critical Accounting Policies

Pursuant to recent SEC guidance, management of the Company is encouraged to evaluate and disclose those accounting policies that are judged to be critical policies, or those most important to the portrayal of the Company's financial condition and results of operations, and that require management's most difficult subjective or complex judgments. Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the inherent subjectivity and uncertainty in estimating the levels of the allowance required to cover credit losses in the portfolio and the material effect that such judgments can have on the results of operations. Included in Note 1 to the Consolidated Financial Statements contained in TrustCo's Annual Report to Shareholders for the year ended December 31, 2016, is a description of this critical policy and the other significant accounting policies that are utilized by the Company in the preparation of the Consolidated Financial Statements.

Availability of Reports

TrustCo's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports can be obtained free of charge from its Internet site, www.trustcobank.com under the "Investor Relations" tab. These reports are available on the Internet site as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. The information found on the Company's website is not incorporated by reference in this or any other report the Company files or furnishes to the SEC. These reports are also available on the SEC's website at http://www.sec.gov.

Forward-Looking Statements

Statements included in this report and in future filings by TrustCo with the SEC, in TrustCo's press releases, and in oral statements made with the approval of an authorized executive officer, which are not historical or current facts, are "forward-looking statements" made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, and are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Forward-looking statements can be identified by the use of such words as may, will, should, could, would, estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. TrustCo wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made.

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TrustCo's 2016 Annual Report to Shareholders, which is included as Exhibit 13 hereto, contains a list of certain important factors, in addition to the factors described under Item 1A. Risk Factors, that in some cases have affected and in the future could affect TrustCo's actual results, and could cause TrustCo's actual financial performance to differ materially from that expressed in any forward-looking statement. The list should not be construed as exhaustive, and TrustCo disclaims any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements, or to reflect the occurrence of anticipated or unanticipated events.

Investors should not rely upon forward-lookin