



**Peoples Financial**  
SERVICES CORP.

**2021** | ANNUAL REPORT

# *In Memoriam*

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**JOHN "JACK" W. ORD**

**1940-2021**

*Former Peoples Neighborhood Bank*

*CEO*

**1969-2007**

*President*

**1974-2006**

*Board Member*

**1969-2009**

*Director Emeritus*

**2006-2008**

# SHAREHOLDERS LETTER

## Dear Shareholders,

Much of last year's shareholder letter chronicled the onset of the COVID-19 pandemic and its impact on our bank and community. As we began 2021, we thought we could see the end of the crisis as vaccines were developed and distributed and businesses began to reopen. And then, just as a sense of normalcy began to return, new variants of the virus appeared, infections and hospitalizations increased, and the government and the CDC implemented new restrictions.

Once again, as they had done in 2020, our employees met the challenge of operating in a pandemic. Prioritizing customer and employee safety led to periodic closing of branch lobbies as employees were forced to work from home. Creative solutions were identified and implemented. Our service standards were maintained and the financial needs of our communities were met.

The efforts of our employees also had an impact on the financial results of Peoples Security Bank & Trust Company and for the fourth consecutive year, we reported record earnings. Earnings for 2021 totaled \$43.5 million or \$6.02 per share. Operating earnings, excluding the impact of the gain on the sale of our Visa shares, were a record \$33.9 million or \$4.69 per share which represented a 20.3% increase over 2020 operating earnings. Robust earnings allowed us to increase our quarterly dividends, which now stand at 39 cents per share, representing a dividend payout ratio of 24.9%.

Results were driven by a \$487 million, or 18.2%, increase in earning assets including a \$151 million, or 6.9%, increase in loans and a \$285 million, or 94%, increase in investments. This asset growth was funded by a \$526 million, or 21.6%, increase in deposits as our efforts to attract new customers benefited from a rapid recovery in the economy.

Expanding assets led to a \$4.8 million or 6.1% in net interest income. Non-interest income, excluding the Visa gain, declined \$3.2 million or 19.0% due to a decline in interest rate swap revenue of \$1.6 million and a decline in mortgage banking revenue of \$0.6 million due to an expected slowdown in mortgage originations. Non-interest expense was in line with the year ago period.

Asset quality remained strong as charge-offs, as a percentage of loans, declined to 0.03% from 0.13%, and non-performing assets, as a percentage of loans, declined to 0.21% from 0.48%. The economic recovery also improved the credit outlook, allowing Peoples Security Bank & Trust

Company to reduce its annual provision for loan losses by \$5.6 million when compared to 2020.

## Peoples Security Bank & Trust Company's Response to the Pandemic

The last two years proved to be especially challenging for our company and our community. The pandemic's impact on the health of our country has been devastating to many. Thousands have died from contracting the virus, including one of our own employees. Millions have been hospitalized, many with long-term effects. We all hope to soon return to "normal life".

During the last two years, our employees consistently have gone above and beyond what was expected of them. In early 2020, we implemented our pandemic response plan. We provided the hardware, software and technical support for more than 180 of our employees to work remotely. More than 50 of our employees who were not able to work remotely were told to stay home as we reduced our in-branch staff to limit possible exposure to the virus. All employees, whether working or not, continued to earn their salary.

Through it all, our employees continued to support our communities. We processed 2,514 Payroll Protection Program loans which provided \$339 million to individuals and businesses impacted by the pandemic. These loans helped businesses in our communities to continue to pay their employees and cover expenses, avoiding what could have been much more dire outcomes. We also assisted our customers who were experiencing financial hardship by granting 986 deferments on more than \$330 million in loan balances. To assist schools within our communities, our company donated more than \$1 million in educational grants.

Peoples Security Bank & Trust Company is proud to have played a role in helping the individuals and businesses in the communities we serve to weather the worst of the pandemic. It's what we do and why we became community bankers.

## Expansion Plan Continues

When the pandemic first hit the United States, we paused our expansion plans and implemented our pandemic liquidity and capital plans. In 2021, as the government addressed some of the worst-case scenarios, we began identifying lending teams in our growth markets to help us resume our expansion efforts. In May, we added a team of lenders in Piscataway, New Jersey. In July, we hired a team leader in





**Craig W. Best**  
CHIEF EXECUTIVE OFFICER

**Thomas P. Tulaney**  
PRESIDENT | COO

**William E. Aubrey II**  
CHAIRMAN OF THE BOARD

Pittsburgh, Pennsylvania who recruited a team of three lenders and two support personnel. In September, we relocated our Binghamton West Side Branch to the south side of Binghamton and purchased land in Doylestown, Pennsylvania to build a new facility to replace our existing smaller facility on Main Street. Our new team members have hit the ground running and were significant contributors to the loan and deposit growth we saw in 2021. We will continue to execute our expansion initiatives as we seek out high performing and reputable lending teams positioned in economically vibrant communities.

In support of our expansion initiatives, we partnered with a leading fintech provider, Q2 Software Inc., to enhance our digital and mobile banking capabilities. With our enhanced digital services, online and mobile banking customers will now be able to see their real time credit scores, transfer money to other banks, and link to accounts from other financial institutions, wealth companies and insurance companies; allowing customers to manage all of their finances from their PSBT mobile app.

**Addition to Our Board**

On March 4, 2022, our Board of Directors appointed Elisa (Lisa) Zúñiga Ramirez to our Board of Directors with a term expiring in 2023. As a result of Ms. Ramirez’s appointment, the Board of Directors was increased from seven members to eight members.

Ms. Ramirez brings more than 30 years of executive-level experience in institutional investing and capital markets with

a proven track record of value creation. Until her retirement in 2020, she was Senior Portfolio Manager and Principal at Segal Bryant and Hamill, an employee-owned money manager with more than \$25 billion in assets under management. Prior to this, she was Senior Portfolio Manager and Partner at Denver Investments LLC, where she was instrumental in growing the small-cap dividend strategy fund from \$100 million to \$2.3 billion in five years. Currently, Ms. Ramirez is the President of Éxito Consulting, LLC.

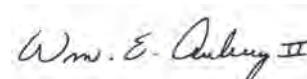
We are excited to have Lisa join our board and are looking forward to having her capital markets experience to drive stakeholder’s value.


**In Conclusion**

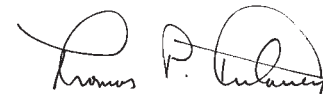
Sadly, 2021 also saw us lose our former CEO, John “Jack” Ord. Jack was CEO of Peoples Neighborhood Bank from 1962 to 2007. During his 45 year span as CEO, the Bank grew from \$3 million to over \$434 million in assets. Jack was a board member from 1969 to 2009. Our Board and employees send our condolences to the Ord family. He will be sadly missed.

We would like to thank our employees for their hard work and dedication throughout the last two very difficult years.

We also want to thank our shareholders for their investment in our company and to remind them of our dividend reinvestment program which allows shareholders to purchase shares without paying broker fees.

  
William E. Aubrey II  
Chairman of the Board

  
Craig W. Best  
Chief Executive Officer

  
Thomas P. Tulaney  
President & COO

**JOIN US ■ VIRTUAL ANNUAL MEETING**  
Saturday, May 14, 2022 at 9:00am  
[www.virtualshareholdermeeting.com/PFIS2022](http://www.virtualshareholdermeeting.com/PFIS2022)

# FINANCIAL HIGHLIGHTS

## PEOPLES FINANCIAL SERVICES CORP. CONSOLIDATED SELECTED FINANCIAL DATA

(Dollars in thousands, except per share data)

Year Ended December 31	2021	2020	2019	2018	2017
<b>Condensed statements of financial performance:</b>					
Interest income	\$ 94,057	\$ 94,125	\$ 93,381	\$ 84,661	\$ 74,242
Interest expense	9,422	14,324	17,868	13,322	8,698
Net interest income	84,635	79,801	75,513	71,339	65,544
Provision for loan losses	1,750	7,400	6,100	4,200	4,800
Net interest income after the provision for loan losses	82,885	72,401	69,413	67,139	60,744
Noninterest income	25,636	16,642	15,120	13,659	17,186
Noninterest expense	55,004	54,868	55,642	52,487	51,293
Income before income taxes	52,915	34,175	28,891	28,311	26,637
Provision for income tax expense	9,998	4,821	3,155	3,391	8,180
Net income	\$ 42,917	\$ 29,354	\$ 25,736	\$ 24,920	\$ 18,457
<b>Condensed statements of financial position:</b>					
Investments securities	\$ 588,674	\$ 303,274	\$ 338,557	\$ 278,334	\$ 281,822
Net loans	2,300,790	2,150,638	1,915,563	1,801,887	1,674,105
Other assets	480,019	429,890	221,207	208,772	213,104
Total Assets	\$ 3,369,483	\$ 2,883,802	\$ 2,475,327	\$ 2,288,993	\$ 2,169,031
Deposits	\$ 2,963,397	\$ 2,437,113	\$ 1,971,489	\$ 1,875,022	\$ 1,719,018
Short-term borrowings		50,000	152,150	86,500	123,675
Long-term debt	2,711	14,769	32,733	37,906	49,734
Subordinated debt	33,000	33,000			
Other liabilities	30,249	32,043	19,945	10,951	11,628
Stockholders' equity	340,126	316,877	299,010	278,614	264,976
Total liabilities and stockholders' equity	\$ 3,369,483	\$ 2,883,802	\$ 2,475,327	\$ 2,288,993	\$ 2,169,031
<b>Per share data:</b>					
Net Income - basic	\$ 5.96	\$ 4.02	\$ 3.48	\$ 3.37	\$ 2.50
Net income - diluted	5.93	4.00	3.47	3.37	2.50
Cash dividends declared	1.50	1.44	1.37	1.31	1.26
Stockholders' equity	\$ 47.44	\$ 43.92	\$ 40.47	\$ 37.66	\$ 35.82
Cash dividends as a percentage of net income	25.29%	35.83%	39.37%	38.87%	50.40%
Average common shares outstanding - basic	7,196,160	7,304,956	7,395,429	7,397,797	7,395,837
Average common shares outstanding - diluted	7,235,303	7,337,843	7,412,369	7,402,900	7,395,837
<b>Selected ratios (based on average balances):</b>					
Net income as a percentage of total assets	1.41%	1.09%	1.10%	1.12%	0.90%
Net income as a percentage of stockholders' equity	13.34	9.48	8.87	9.21	7.02
Stockholders' equity as a percentage of total assets	10.60%	11.48	12.37	12.14	12.77
Tier I capital as a percentage of adjusted total assets	9.16	9.28	10.14	10.03	9.94
Net interest income as a percentage of earning assets	2.99	3.25	3.58	3.59	3.69
Loans, net, as a percentage of deposits	78.60%	95.70%	96.83%	99.55%	98.49%
<b>Selected ratios (based on period end balances):</b>					
Tier I capital as a percentage of risk-weighted assets	12.32%	12.16%	11.90%	11.95%	11.85%
Total capital as a percentage of risk-weighted assets	13.56	15.10	13.04	13.10	12.95
Allowance for loan losses as a percentage of loans, net	1.22	1.26	1.17	1.17	1.12
Nonperforming loans as a percentage of loans, net	0.19%	0.45%	0.52%	0.53%	0.67%

**Note:** Average balances were calculated using average daily balances. Average balances for loans include nonaccrual loans.

Tax-equivalent adjustments were calculated using the prevailing statutory tax rate of 21.0 percent for 2021, 2020, 2019 and 2018, and 35.0 percent for the year 2017.



# LEADERSHIP

## BOARD OF DIRECTORS



**William E. Aubrey II**

Chairman of the Board  
Peoples Financial Services Corp.  
Peoples Security Bank & Trust Company  
President of Alternative Investments  
Gertrude Hawk Holdings



**Craig W. Best**

Chief Executive Officer  
Peoples Financial Services Corp.  
Peoples Security Bank & Trust Company



**Sandra L. Bodnyk**

Retired Banking Executive



**Ronald G. Kukuchka**

President  
Ace Robbins, Inc.



**Richard S. Lochen, Jr.**

Certified Public Accountant  
Partner | Lochen & Chase PC



**James B. Nicholas**

President  
D.G. Nicholas Co.



**Elisa (Lisa) Zúñiga Ramirez**

President  
Éxito Consulting LLC



**Joseph T. Wright, Jr., Esq**

Attorney at Law | Partner  
Wright & Reihner PC

## MANAGEMENT TEAM

**Craig W. Best**

Chief Executive Officer

**Thomas P. Tulaney**

President  
Chief Operating Officer

**Neal D. Koplín**

Senior Executive Vice President  
Chief Banking Officer

**John R. Anderson III**

Executive Vice President  
Chief Financial Officer

**Timothy H. Kirtley**

Executive Vice President  
Chief Risk Officer  
Corporate Secretary

**Susan L. Hubble**

Executive Vice President  
Chief Information Officer

**Joseph M. Ferretti**

Northeast Market President

**Jeffrey A. Drobins**

Lehigh Valley Market President

**Ian Matlack**

Greater Delaware Valley Market President

**Christopher Savena**

Greater Pittsburgh Market President

**Lynn M. Peters Thiel**

Executive Vice President  
Director of Retail Branch  
& Digital Administration

**Thomas C. Cassidy**

Senior Vice President  
Chief Investment Officer  
Wealth Management Division





## EXPANSION PLAN CONTINUES

The year 2021 marked a significant milestone in Peoples Security Bank & Trust Company's long-term expansion strategy, as we penetrated the central New Jersey and western Pennsylvania markets for the first time in our rich corporate history.

The establishment of the business center offices, located in North Allegheny, Pennsylvania and Piscataway, New Jersey, respectively, is another indicator of the Bank's commitment to our growth strategy. These expansion markets were developed around high performing lending teams that can provide a full range of customer friendly banking products and services. The Bank has focused its efforts on selective markets in the Tri-State area where we can create significant opportunities for long-term growth and success.

In October 2021, the North Allegheny office, located at 802B Warrendale Village Drive, Warrendale, Pennsylvania formally opened for business. Our initial focus will specialize in providing commercial and consumer banking products to our prospective customer base. Christopher A. Savena was recruited and appointed as the Pittsburgh Market President and will direct its operations. Mr. Savena has been tasked with onboarding a veteran team of relationship-focused bankers. One of our primary objectives will be to create regional awareness and public visibility within the marketplace. Our banking team will be tasked in providing tailor-made solutions for their respective customers' needs while creating overall satisfaction and loyalty.



PISCATAWAY NJ BUSINESS CENTER



When questioned about the Bank's entry into the region of North Allegheny, Neal Koplin, Senior Executive Vice President, Chief Banking Officer, was quoted as stating, "We are thrilled to be a part of the vibrant Pittsburgh community. We chose to expand to Pittsburgh because of its similarities to the Pennsylvania communities we've served for over 115 years. As a community bank, we pride ourselves on getting to know business owners, community leaders and residents on a personal level, which enables us to customize and personalize their banking experience. We're confident that our new Pittsburgh team will uphold Peoples Security Bank & Trust Company's commitment to putting our customers at the forefront of everything we do while giving back to our communities."

On the heels of our arrival into the Pittsburgh market, the Piscataway NJ Business Center, located at 444 Hoes Lane, Suite 301, Piscataway, New Jersey opened its doors in December 2021. This facility will also offer a full array of commercial and retail loan products for new and existing customers throughout the region. The daily operations will be led by John Pagano, Senior Vice President, New Jersey Market Manager. As seasoned professionals in the banking industry, Mr. Pagano's team will actively promote the Bank's presence in the market focusing on new commercial business activity in the form of lending, advisory, and treasury services for the regional market. Additional team members have joined our team to provide our customers a full relationship banking experience.

While forging ahead with our targeted growth strategy, the Bank also elected to move forward with its relocation plans of our existing Binghamton Branch. We are confident that this decision will provide our upstate New York customers with an improved experience due to its appealing and convenient location. In September 2021, we officially relocated to a new modern office, located at 24 Mary Street, Binghamton, New York. This move was made with no disruption to our customer base and has been well received by our customers and the community.



# PEOPLES SECURITY BANK & TRUST COMPANY INVESTS INTO THE FUTURE WITH ITS ONLINE BANKING PLATFORM

**In an increasingly digital world, our investment into innovation and technology bolsters our customers' access to our banking products and services.**

Over the past few years, the technology landscape of the banking industry has been subjected to a vast number of accelerated and unprecedented changes. One critical area in particular has been the transformation of digital banking as customers demand immediate connectivity, enhanced security, and unrestricted flexibility. The COVID-19 pandemic has forced all sectors, including financial institutions, across the globe to reassess their platforms, processes, and technological tools in order to adapt to the latest trends that are consistent with what existing and future customers are expecting from their financial institution.

After months of extensive planning and preparation by a driven and determined leadership team and our entire professional staff, on September 14, 2021, Peoples Security Bank & Trust Company formally launched its new state-of-the-art online digital & mobile banking platform to all current business and retail customers. In the months preceding its unveiling, employees across our branches and business centers were provided with training and tutorial knowledge to prepare them for the forthcoming changes. By enrolling in our instructional program and allowing our employees to receive experiential learning about the products, services, and capabilities of this dramatically improved platform, we were better able to support our network of customers during this transitional phase and prepared to handle inquiries that arose while offering immediate solutions.

Peoples Security Bank & Trust Company has already experienced success because of this new product. In just over four months since its implementation, the Bank saw a 12% increase in Online Banking customer accounts. As a Bank, we're extremely excited about our investment in this comprehensive online service, as we're now able to offer new customers across our growing footprint a sophisticated digital experience which includes personal financial management, consumer credit monitoring and the ability to access all of their financial accounts in one solution with ready-made convenience from anywhere they conduct their business.

The successful integration of the Online Banking platform is the building block we need for the future. As we continue to progress into the Millennium, the Bank is focused on continuing to deliver the latest digital upgrades and products, as well as modern technological advancements, to support our valuable existing relationships with customers and cultivate new prospects with our portfolio of customer-centric services and capabilities.



# PEOPLES SECURITY BANK & TRUST COMPANY STRIVES TO MAKE OUR COMMUNITIES A BETTER PLACE TO LIVE AND WORK

## For These Executives, It's Demonstrated in Employee Volunteerism.

Being a community bank is about being a part of the community at large as an influential player that fellow neighbors and non-profit organizations can depend on. Since 1905, the Bank's employees have been devoted to giving back and making a difference by volunteering to improve the communities where we are proud to call home. Here are a few spotlight stories where we strengthened our imprint through consistent and meaningful charitable work.

### **Joseph Mahon, Senior Vice President - Corporate Lending Officer, Binghamton NY Region The Boys & Girls Club of Binghamton**

Before joining Peoples Security Bank & Trust Company, Joseph Mahon was actively involved with the Boys & Girls Club of Binghamton. The 501(c)(3) organization allows children and teenagers to have a safe place to go after school and fosters an ability for each individual to reach their full societal potential. Mr. Mahon is proud of the work he's been involved with since he joined in 2005, including his Board experience as the current Treasurer. "The Bank values being an active member of the communities we serve. The Club positively impacts the community today, and it continues to pay dividends long into the future as its members grow into adulthood," remarked Mr. Mahon.

### **Ian Matlack, Senior Vice President - Greater Delaware Market President Retired Senior Volunteer Program (RSVP)**

For Ian Matlack, Peoples Security Bank & Trust Company's forged partnership with RSVP, a social services organization based in King of Prussia, was a personal gravitating fit. As a long-established 501(c)(3) non-profit, RSVP focuses on education and wellness programs for the at-risk and disadvantaged, as well as specialized skill-based programs for non-profits. Since the Bank's sponsorship began in 2018, Mr. Matlack has been involved in two main areas: the Volunteer Executive Consultant program and the America Reads program. In 2019, he was invited to join the RSVP Board.

### **Sharon Borgia, Senior Vice President - Senior Corporate Lending Officer, NEPA Region The Lackawanna Blind Association**

After Sharon Borgia was approached with an opportunity to join the Lackawanna Blind Association, she jumped right in and has served on the Board of the Scranton-based non-profit since 2016. Established in 1912, the Lackawanna Blind Association provides support for the visually impaired. Two major fundraising events are held each year, both of which Ms. Borgia has served on the committees of in recent history: Helen Keller Day and the William J. Jordan, MD Memorial Swing for Sight Golf Tournament. "At the end of each fundraising event, you leave with a feeling that in some way, you helped to make them a success and help those that are in need of the services being offered," stated Ms. Borgia.

Peoples Security Bank & Trust Company believes that genuine relationships drive everything we do, from achieving common goals to responding to the needs of our communities. "Our team has been able to use their expertise in a manner that is collaborative and productive to the organizations they serve. It is gratifying to see and feel those efforts being appreciated and result in positive outcomes," expressed Neal Koplín, Senior Executive Vice President, Chief Banking Officer. The team's involvement in these valued community reinvestment initiatives firmly plants this commitment to our beloved communities that we're passionate about.

# OUR LOCATIONS

## NEW JERSEY

### Piscataway NJ Business Center

444 Hoes Ln, Ste 301, Piscataway, NJ 08854  
(732) 699-2143

## NEW YORK

### Binghamton

24 Mary St, Binghamton, NY 13903  
(607) 729-3832

### Conklin

1026 Conklin Rd, Conklin, NY 13748  
(607) 722-2114

## PENNSYLVANIA

### Abington

1100 Northern Blvd, S Abington Twp, PA 18411  
(570) 587-4898

### Airport Rd

2355 City Line Rd, Bethlehem, PA 18017  
(610) 691-1202

### Central City Scranton

150 N Washington Ave, Scranton, PA 18503  
(570) 955-1700

### Central PA Business Center

830 Norman Dr, Lebanon, PA 17042  
(717) 279-2200

### Doylestown

325 S Main St, Doylestown, PA 18901  
(215) 348-8207

### East Scranton

968 Prescott Ave, Scranton, PA 18510  
(570) 342-9101

### Emrick Blvd

2151 Emrick Blvd, Bethlehem, PA 18020  
(610) 317-4690

### Glenburn

494 N Gravel Pond Rd, Clarks Summit, PA 18411  
(570) 585-5130

### Green Ridge

1901 Sanderson Ave, Scranton, PA 18509  
(570) 346-4695

### Hallstead

25109 State Rt 11, Hallstead, PA 18822  
(570) 879-2195

### Hop Bottom

126 Main St, Hop Bottom, PA 18824  
(570) 289-4124

### King of Prussia

610 Freedom Business Center Dr, Ste 105  
King of Prussia, PA 19406  
(610) 205-1880

### Kingston

435 Wyoming Ave, Kingston, PA 18704  
(570) 288-0128

### Meshoppen

8178 State Rt 6, Meshoppen, PA 18630  
(570) 833-5171

### Minooka

420 Davis St, Scranton, PA 18505  
(570) 955-1883

### Montrose

695 Grow Ave, Montrose, PA 18801  
(570) 278-4100

### Moscow

141 N Main St, Moscow, PA 18444  
(570) 842-7626

### Mount Pocono

1322 Pocono Blvd, Mount Pocono, PA 18344  
(570) 839-8732

### Nicholson

42-48 State St, Nicholson, PA 18446  
(570) 942-2265

### North Allegheny

802B Warrendale Village Dr, Warrendale, PA 15086  
(724) 719-2399

### Old Forge

216 S Main St, Old Forge, PA 18518  
(570) 451-7200

### Peckville

540 Main St, Peckville, PA 18452  
(570) 383-2154

### Susquehanna

215 Erie Blvd, Susquehanna, PA 18847  
(570) 853-4901

### Tilghman St

3920 W Tilghman St, Allentown, PA 18104  
(610) 398-9680

### Tunkhannock

83 E Tioga St, Tunkhannock, PA 18657  
(570) 836-2135

## OFF-SITE ATMs

### Geisinger Commonwealth School of Medicine

525 Pine St, Scranton, PA

### Lackawanna College

501 Vine St, Scranton, PA

### Meadow Avenue

Meadow Ave & Hemlock St, Scranton, PA

### Radisson Lackawanna Station Hotel

700 Lackawanna Ave, Scranton, PA

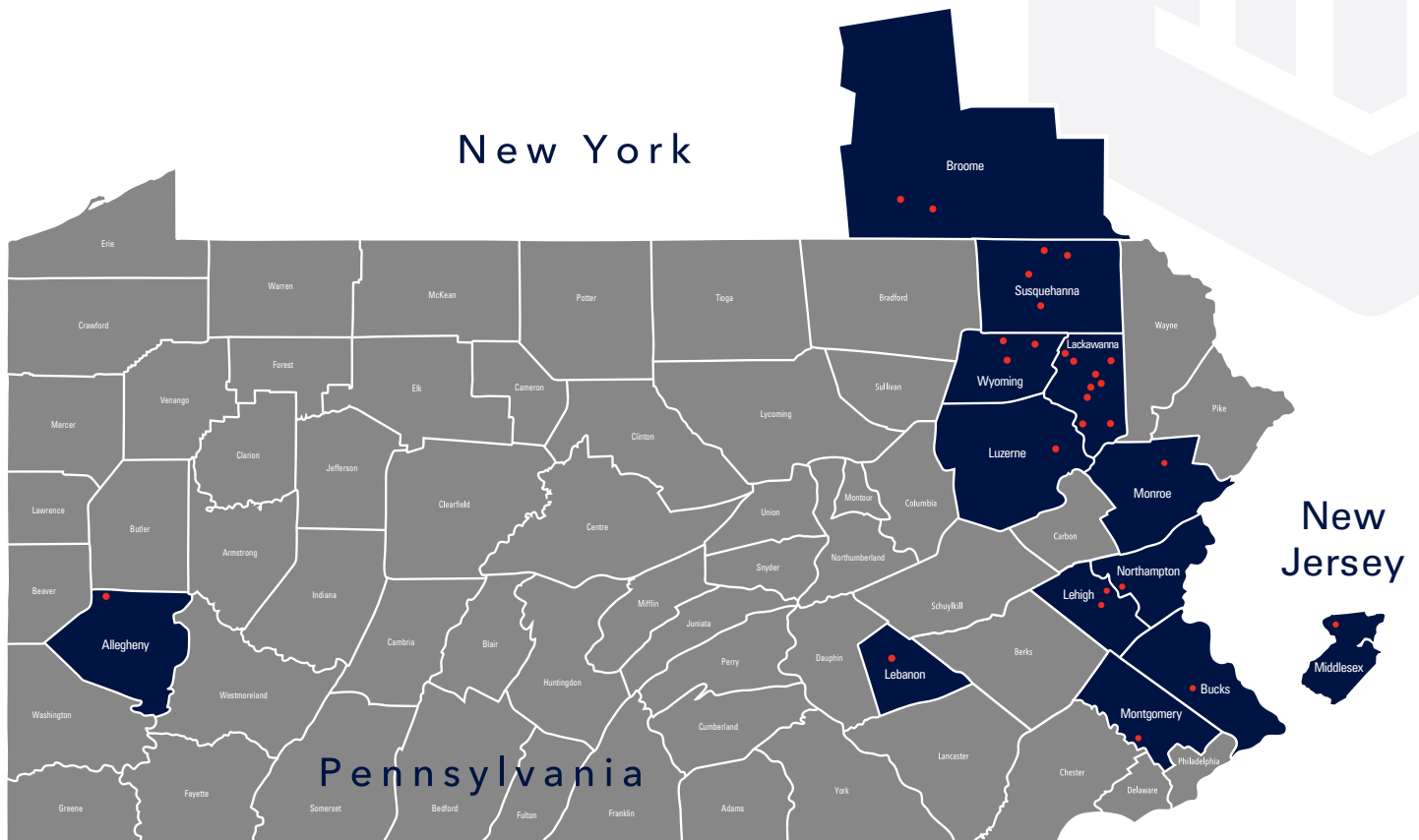
### Saint Mary's Villa Nursing Home

516 Saint Mary's Villa Rd, Elmhurst Twp, PA





# GEOGRAPHIC LOCATIONS



## MISSION STATEMENT

To succeed, we must be constantly aware of the roles played by our shareholders, our customers, our communities, and our employees.

**We will work together to:**

- Exceed customers' expectations as we proactively help them achieve their goals
- Create a dynamic environment that promotes life-long learning and personal growth of employees
- Help to make our communities better places to live and work by being an important contributor of time, talent and resources

# CORPORATE INFORMATION

## CORPORATE HEADQUARTERS

150 North Washington Avenue | Scranton, PA 18503  
(570) 346-7741 | (888) 868-3858 | psbt.com

## INVESTOR RELATIONS OFFICER

Marie L. Luciani | (570) 346-7741 x2352 | (888) 868-3858 x2352

## STOCK INFORMATION

The common stock of Peoples Financial Services Corp. is listed on the NASDAQ Stock Market under the ticker symbol PFIS.

## STOCK TRANSFER AND REGISTRAR AGENT

### AMERICAN STOCK TRANSFER & TRUST COMPANY, LLC

6201 15th Avenue | Brooklyn, NY 11219  
(718) 921-8124 | (800) 937-5449

## FORM 10-K ANNUAL REPORT

A copy of our form 10-K for the year ended December 31, 2021 is included herein. **Copies of the company's Annual Report to the Securities and Exchange Commission on Form 10-K, quarterly reports on Form 10-Q and news releases may be obtained without charge upon request to:**

Marie L. Luciani | Investor Relations Officer  
150 North Washington Avenue | Scranton, PA 18503

## VIRTUAL ANNUAL MEETING

Saturday, May 14, 2022, 9:00am  
[www.virtualshareholdermeeting.com/PFIS2022](http://www.virtualshareholdermeeting.com/PFIS2022)

## DIVIDEND CALENDAR

Dividends on Peoples Financial Services Corp. common stock are customarily payable on or about the 15th of March, June, September and December.

## DIVIDEND REINVESTMENT PLAN

American Stock Transfer & Trust Company, LLC administers a Dividend Reinvestment Plan and Stock Purchase Plan. Additional information may be obtained on American Stock Transfer & Trust Company's website: [astfinancial.com](http://astfinancial.com).

## DIRECT DEPOSIT OF DIVIDENDS

As a shareholder of Peoples Financial Services Corp., you may have your dividend payments deposited directly into a personal checking, savings, or other account. Direct deposit of your dividend eliminates the chance of your dividend check being lost or stolen and is credited to your account on the same day that the dividend is paid. To begin direct deposit of your dividend, please contact Marie L. Luciani, Investor Relations Officer, at the Corporate Headquarters address.

## INDEPENDENT AUDITORS

Baker Tilly US, LLP  
7535 Windsor Drive, Suite 300 | Allentown, PA 18195-1014  
(610) 336-8180

## GENERAL COUNSEL

Jerry Weinberger, Esq. | Jerry Weinberger P.C.  
345 Wyoming Avenue | Suite 200 | Scranton, PA 18503  
(570) 963-8880

## SEC COUNSEL

Troutman Pepper Hamilton Sanders, LLP  
3000 Two Logan Square | Eighteenth & Arch Streets  
Philadelphia, PA 19103 | (215) 981-4000

## TRUST COUNSEL

James W. Reid, Esq. | Oliver, Price & Rhodes  
1212 South Abington Road | Clarks Summit, PA 18411  
(570) 585-1200

## MARKET MAKERS

Boenning & Scattergood, Inc.  
4 Tower Bridge | 200 Barr Harbor Drive | Suite 300  
West Conshohocken, PA 19428 | (610) 862-5368

Griffin Financial Group, LLC  
440 Monticello Avenue | Suite 1824 | Norfolk, VA 23510  
(757) 955-8444

Keefe Bruyette & Woods (KBW)  
The Equitable Building | 787 7th Avenue | New York, NY 10019  
(212) 887-8996

Piper Sandler  
1251 Avenue of the Americas | 6th Floor | New York, NY 10020  
(800) 635-6851

## PRODUCTS AND SERVICES

Detailed information on our products and services offered by Peoples Security Bank & Trust Company can be obtained by visiting [psbt.com](http://psbt.com) or by calling (888) 868-3858 or (570) 346-7741.



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

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2021

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: 001-36388

**Peoples Financial Services Corp.**

(Exact name of registrant as specified in its charter)

Pennsylvania  
State or other jurisdiction of  
incorporation or organization

23-2391852  
(I.R.S. Employer  
Identification No.)

150 North Washington Avenue,  
Scranton, PA 18503  
(Address of principal executive offices) (Zip Code)

(570) 346-7741

Registrant's telephone number, including area code

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

Title of each class  
Common stock, \$2.00 par value

Trading Symbol  
PFIS

Name of each exchange on which registered  
The Nasdaq Stock 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 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 and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. Yes  No

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on June 30, 2021 was \$306,836,213 (based on the closing sales price of the registrant's common stock on that date).

The number of shares of the registrant's common stock outstanding as of February 28, 2022 was 7,168,312.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement to be filed in connection with solicitation of proxies for its 2022 annual meeting of shareholders, within 120 days of the end of registrant's fiscal year, are incorporated by reference into Part III of this Annual Report on Form 10-K.



**Peoples Financial Services Corp.**  
**Form 10-K**  
**For the Year Ended December 31, 2021**  
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### **Cautionary Note Regarding Forward-Looking Statements.**

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to risks and uncertainties. These statements are based on assumptions and may describe future plans, strategies and expectations of Peoples Financial Services Corp. and its subsidiaries. These forward-looking statements are generally identified by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project” or similar expressions. All statements in this report, other than statements of historical facts, are forward-looking statements.

The ability of Peoples Financial Services Corp. to predict results or the actual effect of future plans or strategies is inherently uncertain. Important factors that could cause our actual results to differ materially from those in the forward-looking statements include, but are not limited to: the continuing coronavirus (“COVID-19”) crisis and the governmental responses to the crisis; risks associated with business combinations; changes in interest rates; economic conditions, particularly in our market area; legislative and regulatory changes and the ability to comply with the significant laws and regulations governing the banking and financial services business; monetary and fiscal policies of the U.S. government, including policies of the U.S. Department of Treasury and the Federal Reserve System; political, legal, and regulatory actions and policies in response to the military conflict between Russia and Ukraine, including the effects thereof on energy markets, interest rates, commerce and banking; credit risk associated with lending activities and changes in the quality and composition of our loan and investment portfolios; demand for loan and other products; deposit flows; competition; changes in the values of real estate and other collateral securing the loan portfolio, particularly in our market area; changes in relevant accounting principles and guidelines; inability of third party service providers to perform; and our ability to prevent, detect and respond to cyberattacks. Additional factors that may affect our results are discussed in Item 1A to this Annual Report on Form 10-K titled “Risk Factors”.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, we do not undertake, and specifically disclaim any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

## **Part I**

### **Item 1. Business.**

#### **General**

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company.

Unless the context indicates otherwise, all references in this annual report to the “Peoples,” “Company,” “we,” “us” and “our” refer to Peoples Financial Services Corp. and its subsidiaries. Peoples Security Bank and Trust Company is sometimes referred to as “Peoples Bank.”

Peoples Bank is a state-chartered bank and trust company under the jurisdiction of the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation, or “FDIC.” Peoples Bank’s twenty-eight community banking offices, all similar with respect to economic characteristics, share a majority of the following aggregation criteria: products and services; operating processes; customer bases; delivery systems; and regulatory oversight. Accordingly, they are aggregated into a single operating segment.

#### **Market Areas**

Our principal market area consists of Allegheny, Bucks, Lackawanna, Lebanon, Lehigh, Luzerne, Monroe, Montgomery, Northampton, Susquehanna, Wayne and Wyoming Counties in Pennsylvania, Middlesex County in New Jersey and Broome County in New York. In addition, parts of Bradford and Schuylkill Counties in Pennsylvania are also considered part of the market area. We maintain our headquarters in Scranton, the largest city in Lackawanna County.

Our legacy market we consider to stretch from Binghamton and the southern tier of New York down through Northeastern Pennsylvania. Our growth strategy expanded our operations into the Greater Lehigh Valley, King of Prussia and the Greater Delaware Valley of southeastern Pennsylvania and suburban Philadelphia, and south central Pennsylvania. Most recently, we expanded into the Greater Pittsburgh region and into New Jersey with a branch office in Piscataway.

Peoples commenced a growth strategy during the fourth quarter of 2014 with the opening of a community banking office in the Lehigh County market. During 2017, the Company added two additional branch offices, one in Allentown, Lehigh County and one in Bethlehem, Northampton County to continue our strategic expansion initiative into the Greater Lehigh Valley market. This market has a greater population than the other counties served, with Bethlehem being the second largest city within Lehigh County.

In 2015, the Company entered the King of Prussia market, which includes parts of Bucks and Montgomery counties of Pennsylvania and suburban Philadelphia, with the establishment of a loan production office and a team of experienced lenders. During the fourth quarter of 2016, a retail branch office was established, replacing the loan production office, and staffed by personal bankers and our experienced lenders. Montgomery and Bucks counties are two of the wealthiest counties in Pennsylvania. Significant types of employment industries include pharmaceuticals, health care, electronics, computer services, insurance, industrial machinery, retailing, schools and meat processing.

In 2019, the Company entered the south central Pennsylvania market with the establishment of a full-service branch in Lebanon County. A team of experienced lenders in this market was recruited to serve the Lancaster, Lebanon, and Harrisburg market. In 2020, the bank expanded further into the Greater Delaware Valley by opening a branch office in Doylestown, Bucks County and recruiting an experienced lending team.

During the fourth quarter of 2021, the Company continued its growth strategy by opening branches in both Warrendale, Pennsylvania, serving the Greater Pittsburgh market, and Piscataway, New Jersey, serving the New Jersey market. Experienced lenders have been recruited to manage these new markets.



In 2020, the Company permanently closed its Duryea, Gouldsboro, and South Scranton branches which had been temporarily closed during the pandemic. Each of the branches were consolidated into branches within close proximity and we re-allocated the operating expenses to the markets identified in our growth strategy.

The Marcellus Shale formation located in the heart of our legacy market area has provided economic benefits to the communities served and as a result to us. Natural gas producers have invested billions of dollars in Pennsylvania in lease and land acquisition, new well drilling, infrastructure development and community partnerships.

## **COVID-19**

Operationally, as COVID-19 events unfold, our continued priority is the health and safety of our customers and employees. We continue to follow the recommendations of our state governments as to conducting business and continue to maintain safety protocols. Currently all our offices have returned to pre-pandemic operating hours with full lobby access.

On March 22, 2020, the federal banking agencies issued an “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus.” The guidance explained that in consultation with the Financial Accounting Standards Board (“FASB”) staff the federal banking agencies concluded that short-term modifications (e.g. six months) made on a good faith basis to borrowers who were current as of the implementation date of a modification are not Troubled Debt Restructurings (“TDRs”). The Coronavirus Aid, Relief and Economic Security (“CARES”) Act was passed by Congress on March 27, 2020. Section 4013 of the CARES Act also addressed COVID-19 related modifications and specified that COVID-19 related modifications on loans that were not more than 30 days past due as of December 31, 2019 are not TDRs. On December 27, 2020, another COVID-19 relief bill was signed that extended this guidance until the earlier of January 1, 2022 or 60 days after the date on which the national emergency declared as a result of COVID-19 is terminated. During 2020, the Bank had applied this guidance and modified 479 commercial loans with an outstanding balance of \$306.8 million and 512 consumer loans with an outstanding balance of \$23.3 million. As of December 31, 2021, all of these modifications had expired and the loans returned to their contractual payment terms.

The CARES Act, as amended, included an allocation of \$659 billion for loans to be issued by financial institutions through the Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”). PPP loans are forgivable, in whole or in part, if the proceeds are used for payroll and other permitted purposes in accordance with the requirements of the PPP. These loans carry a fixed rate of 1.00% and a term of two years (loans made before June 5, 2020) or five years (loans made on or after June 5, 2020), if not forgiven, in whole or in part. Payments are deferred until either the date on which the SBA remits the amount of forgiveness proceeds to the lender or the date that is 10 months after the last day of the covered period if the borrower does not apply for forgiveness within that 10 month period. Through December 31, 2020, the Bank had originated 1,450 PPP loans totaling \$217.5 million in principal, with an average loan size of \$150,000. The PPP loans originated during 2020 generated net fees totaling \$5.2 million. These fees are deferred and accreted into interest income over the contractual period of 24 months or 60 months, as applicable. Upon SBA forgiveness, unamortized fees are then recognized into interest income. Participation in the PPP had a significant impact on the Bank’s asset mix and net interest income in 2021 and 2020 and will continue to impact both asset mix and net interest income until these loans are forgiven or paid off. The initial PPP expired on August 8, 2020. Through December 31, 2020, PPP loans totaling \$27.8 million had been forgiven by the SBA and a total of \$2.3 million in PPP net fees had been recognized by the Bank.

On December 27, 2020, another COVID-19 relief bill was signed that extended and modified several provisions of the PPP. This included an additional allocation of \$284 billion. The SBA reactivated the PPP on January 11, 2021. The Bank originated additional loans through the PPP, which expired on May 31, 2021. During 2021, the Bank had generated and received SBA approval on 1,062 PPP loans totaling \$121.6 million and generated \$4.3 million in related deferred PPP net fees. During 2021, PPP loans totaling \$244.3 million had been forgiven by the SBA and a total of \$7.1 million in PPP net fees and interest income had been recognized by the Bank including fees recognized upon forgiveness and continuing amortization of fees from the 2020 and 2021 PPP originations. At December 31, 2021, PPP

loan balances total \$68.8 million with remaining unamortized fees of \$1.7 million. We expect the majority of the loans to be forgiven and the net fees recognized into net interest income during the first six months of 2022.

## **Human Capital Resource**

*Staffing.* At December 31, 2021, our 370 full-time employees and 26 part-time employees are the keys to the success of Peoples. We are committed to attracting, retaining and promoting top quality talent regardless of race, color, religion, sex, sexual orientation, gender identity, national origin, age, disability or genetic information. We strive to identify and select the best candidates for all open positions based on qualifying factors for each job. We are dedicated to providing a workplace for our employees in which they are treated with dignity, decency and respect; that is inclusive, supportive, and free of any form of discrimination or harassment; rewarding and recognizing our employees based on their individual results and performance; and recognizing and respecting all of the characteristics and differences that make each of our employees unique.

*Core values.* We strive to meet our core values of integrity, excellence, teamwork and efficiency. Integrity is our foundation, the basis of everything we do, to be professional, honest, trustworthy, confidential and respectful at all times. We work together for a common good, engage our customers, coworkers, and partners. We work together to exceed our customers' expectations as we pro-actively help them achieve their goals, to create a dynamic environment that promotes life-long learning and personal growth of our employees, and to help to make our communities better places to live and work by being an important contributor of time, talent, and resources.

*Diversity, Equity and Inclusion.* Peoples is committed to fostering, cultivating and preserving a culture of diversity and inclusion. Our human capital is the most valuable asset we have. The collective sum of the individual differences, life experiences, knowledge, inventiveness, innovation, self-expression, unique capabilities and talent that our employees invest in their work represents a significant part of not only our culture, but our reputation and company's achievement as well.

We embrace and encourage our employees' differences in age, color, disability, ethnicity, family or marital status, gender identity or expression, language, national origin, physical and mental ability, political affiliation, race, religion, sexual orientation, socio-economic status, veteran status, and other characteristics that make our employees unique.

*Health & Safety.* Our health and safety policies, procedures and guidelines mandate all tasks be conducted in a safe and efficient manner complying with all local, state and federal safety and health regulations, and special safety concerns. Our policies and procedures encompass all facilities and operations and addresses on-site emergencies, injuries and illnesses, evacuation procedures, cell phone usage and general safety rules.

As the COVID-19 crisis unfolded throughout 2021, the safety and well-being of our employees and families, customers, and communities were our top priority. We continue to implement our pandemic plan and execute various strategies and protocols intended to protect our employees, maintain services for customers, assure functional continuity of the Company's operating systems, controls and processes, and mitigate financial risks posed by changing market conditions. We continue to follow the recommendations of our state and local governments as to conducting business and continue to maintain safety protocols.

*Benefits.* We are committed to offering a competitive total compensation package. We regularly compare compensation and benefits with peer companies and market data, making adjustments as needed to ensure compensation stays competitive. We also offer a wide array of benefits for our workforce and their families, including:

- Comprehensive medical, dental, and vision benefits, as well as group life insurance, accidental death and dismemberment insurance, voluntary life insurance, and short-term and long-term disability insurance for all eligible employees
- Employee Assistance Program

- 401(k) Profit Sharing Plan
- Employee Stock Ownership Plan (ESOP)
- Disaster pay
- Paid time off (PTO), holidays and bank holidays
- Unpaid leave of absence
- Internal training and online development courses
- Tuition reimbursement for eligible associates

## **Products and Services**

Our primary commercial loan products are centered around small and medium sized businesses; various types of Commercial Real Estate Loans; and Municipal & Non-Profit Tax Free Loans. Other lending products include one-to-four family residential mortgages, home equity loans and consumer & auto loans. We fund our loans, primarily, by offering deposits to individuals; commercial business customers; municipalities, school districts and other non-profit organizations. Our deposit products include certificates of deposit, money market accounts, savings accounts and various demand deposit accounts.

We generate interest income from our loan and securities portfolios. Other income is generated primarily from merchant transaction fees, trust and wealth management fees, fees generated from commercial loan interest rate swap transactions and service charges on deposit accounts. Our primary costs are interest paid on deposits and borrowings and general operating expenses. We provide a variety of commercial and retail banking services to business, non-profits, governmental, municipal agencies and professional customers, as well as retail customers, on a personalized basis. Our primary lending products are real estate, commercial and consumer loans. We also offer ATM access, credit cards, active investment accounts, trust department services and other various lending, depository and related financial services. Our primary deposit products are savings and demand deposit accounts and certificates of deposit.

We are not dependent upon a single customer, or a few customers, the loss of one or more of which would have a material adverse effect on our operations. In the ordinary course of our business, our operations and earnings are not materially affected by seasonal changes or by compliance with federal, state or local environmental laws or regulations.

### *Lending Activities*

We provide a full range of retail and commercial lending products designed to meet the borrowing needs of consumers and small- and medium-sized businesses in our market areas. The majority of our loans are to customers located within our market area. We have no foreign loans or highly leveraged transaction loans, as defined by the Federal Reserve Board. Although we participate in loans originated by other banks, we have originated the majority of the loans in our portfolio.

Our retail lending products include the following types of loans, among others: residential real estate; automobiles; manufactured housing; personal and home equity. Our commercial lending products include the following types of loans, among others: commercial real estate; working capital; equipment and other commercial needs; construction; SBA; and agricultural and mineral rights. The terms offered on a loan vary depending primarily on the type of loan and credit-worthiness of the borrower.

Payment risk is a function of the economic climate in which our lending activities are conducted. Economic downturns in the economy generally or in a particular sector could cause cash flow problems for customers and make loan payments more difficult. We attempt to minimize this risk by not being exposed to loan concentrations of a single customer or a

group of customers, the loss of any one or more of whom would have a materially adverse effect on our financial condition. One element of interest rate risk arises from our fixed rate loans in an environment of changing interest rates. We attempt to mitigate this risk by making adjustable rate commercial loans and by limiting repricing terms to five years or less for customers requiring fixed rate loans. Our lending activity also exposes us to risks that any collateral we take as security is not adequate. We attempt to manage collateral risk by avoiding loan concentrations to particular borrowers, by perfecting liens on collateral and by obtaining appraisals on property prior to extending loans. We attempt to mitigate our exposure to these and other types of risks by stratifying authorization requirements by loan size and complexity.

We offer a variety of loans including commercial, residential and consumer loans as described above. The consumer portfolio includes automobile loans, educational loans and lines of credit.

We intend to continue to evaluate commercial real estate, commercial business and governmental lending opportunities, including small business lending. We continue to proactively monitor and manage existing credit relationships.

We have not engaged in sub-prime residential mortgage lending, which is defined as mortgage loans advanced to borrowers who do not qualify for market interest rates because of problems with their credit history. We focus our lending efforts within our market area.

*One-to-Four Family Residential Loans.* We offer two types of residential mortgage loans: fixed-rate loans, with terms of up to 30 years, and adjustable-rate loans, with interest rates and payments that adjust annually after an initial fixed period of one, three, five or ten years. Interest rates and payments on our adjustable-rate loans generally are adjusted to a rate equal to a percentage above the appropriate U.S. Treasury Security Index. Our adjustable-rate single-family residential real estate loans generally have caps on increases or floors on decreases in the interest rate at any adjustment date, and a maximum adjustment limit over the life of the loan. Although we offer adjustable-rate loans with initial rates below the fully indexed rate, loans tied to the one-year constant maturity Treasury are underwritten using methods approved by the Federal Home Loan Mortgage Corporation, which require borrowers to be qualified at a rate equal to 200 basis points above the discounted loan rate under certain conditions.

Borrower demand for adjustable-rate loans compared to fixed-rate loans is a function of the level of interest rates, the expectations of changes in the level of interest rates, and the difference between the interest rates and loan fees offered for fixed-rate mortgage loans as compared to the interest rates and loan fees for adjustable-rate loans, among other factors. The loan fees, interest rates and other provisions of mortgage loans are determined by us on the basis of our own pricing criteria and competitive market conditions.

Most of our residential loans are underwritten to standards established by the secondary market.

While one-to-four family residential real estate loans are normally originated with up to 30-year terms, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full either upon sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans. We do not offer loans with negative amortization or interest only loans.

We offer home equity loans and lines of credit, typically with a maximum combined loan-to-value ratio of 80%. Home equity loans generally have fixed-rates of interest and are originated with terms of up to 15 years. Home equity lines of credit generally have variable rates and are indexed to the prime rate. Home equity lines of credit generally have draw periods with 20 year repayment periods.

We generally do not make high loan-to-value loans (defined as loans with a loan-to-value ratio in excess of 80%) without private mortgage insurance. The maximum loan-to-value ratio we generally permit is 95% with private mortgage insurance. We require all properties securing residential mortgage loans to be appraised by a board-approved independent appraiser. We generally require title insurance on all first mortgage loans. Borrowers must obtain hazard insurance, and flood insurance is required for loans on properties located in a flood zone.



*Commercial Real Estate Loans.* We offer commercial real estate loans secured by real estate with adjustable and fixed rates. We originate a variety of commercial real estate loans generally for terms up to 25 years and payments based on an amortization schedule of up to 25 years. These loans are typically based on either the Federal Home Loan Bank borrowing rate or our own pricing criteria and adjust every three, five, seven or ten years. Commercial real estate loans also are originated for the acquisition and development of land, including development for residential use. Conditions of acquisition and development loans originated generally limit the number of model homes and homes built on speculation, and draws are scheduled against executed agreements of sale. Commercial real estate loans for the acquisition and development of land are typically based upon the prime rate. Commercial real estate loans for developed real estate and for real estate acquisition and development are originated generally with loan-to-value ratios up to 75%, while loans for the acquisition of land are originated with a maximum loan to value ratio of 65%.

Loans secured by commercial real estate generally have larger balances and involve a greater degree of risk than one-to-four family residential mortgage loans. Of primary concern in commercial real estate lending is the borrower's and any guarantor's creditworthiness and the feasibility and cash flow potential of the financed project. Additional considerations include: location, market and geographic concentrations, loan to value, strength of guarantors and quality of tenants. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans, to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, we require borrowers and loan guarantors, if any, to provide annual consolidated financial statements on commercial real estate loans and rent rolls where applicable. In reaching a decision on whether to make a commercial real estate loan, we consider and review a cash flow analysis of the borrower and guarantor, when applicable, and consider the net operating income of the property, the borrower's expertise, credit history and profitability and the value of the underlying property. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.2 times. An environmental report is obtained when the possibility exists that hazardous materials may exist or have existed on the site, or the site may be or have been impacted by adjoining properties that handled hazardous materials.

*Commercial Loans.* We offer commercial business loans to professionals, sole proprietorships and small businesses in our market area. We offer term loans for capital improvements, equipment acquisition and long-term working capital. These loans are typically priced at short term fixed rates or variable rates based on the prime rate. These loans are secured by business assets other than real estate, such as business equipment and inventory, and, generally, are backed by personal guarantees of the owner or owners of the business. We originate lines of credit to finance the working capital needs of businesses to be repaid by seasonal cash flows or to provide a period of time during which the business can borrow funds for planned equipment purchases.

We have participated in the PPP, a \$350 billion specialized low-interest loan program funded by the U.S. Treasury Department and administered by the SBA. The PPP provides borrower guarantees for lenders, as well as loan forgiveness incentives for borrowers that utilize the loan proceeds to cover employee compensation-related business operating costs.

When making commercial business loans, we consider the consolidated financial statements of the borrower and any guarantors, the borrower's payment history of both corporate and personal debt, the debt service capabilities of the borrower, the projected cash flows of the business and guarantor, the viability of the industry in which the customer operates and the value of the collateral.

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income, and which are secured by real property, the value of which tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

*Consumer Loans.* We offer a variety of consumer loans, including lines of credit, automobile loans and loans secured by savings accounts and certificates of deposit. We also offer unsecured loans.

Consumer loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly, such as motor vehicles. In the latter case, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and a small remaining deficiency often does not warrant further substantial collection efforts against the borrower. Consumer loan collections depend on the borrower's continuing financial stability, and therefore are likely to be adversely affected by various factors, including job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state insolvency laws, may limit the amount that can be recovered on such loans.

Loans secured by new and used automobiles are offered, primarily indirectly through dealerships. These loans have fixed interest rates and generally have terms up to seven years. We offer automobile loans with loan-to-value ratios of up to 100% or more of the purchase price of the vehicle depending upon the credit history of the borrower and other factors.

Consumer loans secured by savings accounts and certificates of deposit held by us are offered based upon the deposit rates plus a margin with terms up to five years. We offer such loans up to 100% of the principal balance of the certificate of deposit or balance in the savings account. We also offer unsecured loans and lines of credit with terms up to five years. Our unsecured loans and lines of credit bear a substantially higher interest rate than our secured loans and lines of credit.

The procedures for underwriting consumer loans include an assessment of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although the applicant's creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount.

We have adhered and continue to adhere to credit policies, which management believes are sound. Our loan policies require verification of information provided by loan applicants as well as an assessment of their ability to repay for all loans. At no time have we made loans similar to those commonly referred to as "no doc" or "stated income" loans.

While the vast majority of the loans in our loan portfolio are secured by collateral, we have made and will continue to make loans on an unsecured basis. Unsecured commercial loans are only granted to those borrowers exhibiting historically strong cash flow and capacity with seasoned management. Unsecured consumer loans are made for relatively short terms and to borrowers with strong credit histories.

Requests to modify, restructure or otherwise change the terms of loans are considered on an individual basis as circumstances and/or reasons for such changes may vary. All such changes in terms must be authorized by the appropriate approval body. Also, our credit policy prohibits the modification of loans or the extension of additional credit to borrowers who are not current on their payments. Exceptions are approved only where our position in the credit relationship is expected to be enhanced by such action.

*Adjustable-Rate Loans.* While we anticipate that adjustable-rate loans will better offset the adverse effects of an increase in interest rates as compared to fixed-rate loans, an increased monthly loan payment required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of collateral also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans make our asset base more responsive to changes in interest rates, the extent of this interest sensitivity is limited by the annual and lifetime interest rate adjustment limits on residential mortgage loans. We attempt to negotiate floors on most adjustable rate commercial loans. The commercial adjustable rate loans generally provide a fixed rate re-negotiation at the end of the initial fixed rate period. If we and the borrower are unable to agree on a new fixed rate then the rate converts to a floating rate obligation. In addition, some commercial loans adjust to a predetermined index plus a spread at the end of the initial fixed rate period, for a like period of time. To a lesser degree, we have entered into transactions with collars generally for periods of five years or less.

*Loan Originations.* Loan originations come from a number of sources. The primary sources of loan originations are existing customers, walk-in traffic, advertising and referrals from customers. We also purchase participations in loans from local financial institutions to supplement our lending portfolio. Loan participations are subject to the same credit analysis and loan approvals as the loans we originate. We are permitted to review all of the documentation relating to any loan in which we participate. However, in a purchased participation loan, we do not service the loan and are subject to the policies and practices of the lead lender with regard to monitoring delinquencies, pursuing collections and instituting foreclosure proceedings.

*Loan Approval Procedures and Authority.* Our lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by our board of directors and management. The board of directors has granted loan approval authority to certain officers or groups of officers up to prescribed limits, based on the officer's experience.

*Loans to One Borrower.* The maximum amount that we may lend to one borrower and the borrower's related entities generally is limited, by regulation, to 15% of the capital accounts of Peoples Bank. Capital accounts include the aggregate of capital, surplus, undivided profits, capital securities and reserve for loan losses. At December 31, 2021, our regulatory limit on loans to one borrower was \$50.7 million.

#### *Deposit Activities*

Our primary source of funds is the cash flow provided by our financing activities, mainly deposit gathering. Other sources of funds are provided by investing activities, including principal and interest payments on loans and investment securities, and operating activities, primarily net income. We offer a variety of deposit accounts with a range of interest rates and terms, including, among others: money market accounts; NOW accounts; savings accounts; certificates of deposit; individual retirement accounts, and demand deposit accounts. These deposits are primarily obtained from areas surrounding our branch offices. We rely primarily on marketing, product innovation, technology, service and long-standing relationships with customers to attract and retain these deposits. Other deposit related services include: remote deposit capture; automatic clearing house transactions; cash management services; automated teller machines; point of sale transactions; safe deposit boxes; night depository services; direct deposit, and official check services.

#### *Trust, Wealth Management and Brokerage Services*

Through our trust department, we offer a broad range of fiduciary and investment services. Our trust and investment services include investment management, IRA trustee services, estate administration, living trusts, trustee under will, guardianships, life insurance trusts, custodial services / IRA custodial services, corporate trusts, and pension and profit sharing plans.

We provide a comprehensive array of wealth management products and services to individuals, small businesses and nonprofit entities. These products and services include the following, among others: investment portfolio management; estate planning; annuities; business succession planning; insurances; retirement plan services; education funding strategies, and tax planning.

We have a third party marketing agreement with a broker-dealer that allows us to offer a full range of securities, brokerage services and annuity sales to our customers. Our investor services division is located in our headquarters building and the services are offered throughout the branch system. Through this relationship, our clients have access to a wide array of financial and wealth management strategies, including services such as professional money management, retirement and education planning, and investment products including stocks, bonds, mutual funds, annuities and insurance products.

#### *Merchant Services*

We offer credit card processing and a variety of other products and services to our merchant customers, through a marketing and sales agreement with an industry leader in payment processing services. Services include small business

checking accounts, merchant money market accounts, online banking, telephone banking, business credit cards, merchant line of credit and financial checkup.

## **Competition**

We compete primarily with commercial banks, online financial institutions, thrift institutions and credit unions, many of which are substantially larger in terms of assets and available resources. Certain of these institutions have significantly higher lending limits than we do, and may provide various services for their customers that we presently do not. In addition, we experience competition for deposits from mutual funds and security brokers, while consumer discount, mortgage and insurance companies compete for various types of loans. Credit unions, finance companies and mortgage companies enjoy certain competitive advantages over us, as they are not subject to the same regulatory restrictions and taxations as commercial banks. Principal methods of competing for bank products, permitted nonbanking services and financial activities include price, nature of product, quality of service and convenience of location.

In our market area, we expect continued competition from these financial institutions in the foreseeable future. With the continued acceptance of internet banking by our customers and consumers generally, competition for deposits has increased from institutions operating outside of our market area.

We believe that our most significant competitive advantage originates from our business philosophy which includes offering direct access to senior management and other officers and providing friendly, informed and courteous service, local and timely decision making, flexible and reasonable operating procedures and consistently applied credit policies. In addition, our success has been, and will continue to be, a result of our emphasis on community involvement and customer relationships. With consolidation continuing in the financial industry, and particularly in our market area, community banks like us are gaining opportunities and market share as larger institutions reduce their emphasis on or exit our market area.

## **Seasonality**

Generally, our operations are not seasonal in nature.

## **Supervision and Regulation**

We are extensively regulated under federal and state laws. Generally, these laws and regulations are intended to protect consumers, not shareholders. The following is a summary description of certain provisions of law that affect the regulation of bank holding companies and banks. This discussion is qualified in its entirety by reference to applicable laws and regulations. Changes in law and regulation may have a material effect on our business and prospects.

Peoples is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended, and is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System, referred to as the "Federal Reserve Board" or the "FRB." We are required to file annual and quarterly reports with the FRB and to provide the FRB with such additional information as the FRB may require. The FRB also conducts examinations of Peoples.

With certain limited exceptions, we are required to obtain prior approval from the FRB before acquiring direct or indirect ownership or control of more than 5% of any voting securities or substantially all of the assets of a bank or bank holding company, or before merging or consolidating with another bank holding company. Additionally, with certain exceptions, any person or entity proposing to acquire control through direct or indirect ownership of 25% or more of our voting securities is required to give 60 days' written notice of the acquisition to the FRB, which may prohibit the transaction, and to publish notice to the public.

Peoples Bank is regulated by the Pennsylvania Department of Banking and Securities (the "Department of Banking") and the FDIC. The Department of Banking may prohibit an institution over which it has supervisory authority from engaging in activities or investments that the agency believes constitute unsafe or unsound banking practices. Federal banking regulators have extensive enforcement authority over the institutions they regulate to prohibit or correct

activities that violate law, regulation or a regulatory agreement or which are deemed to constitute unsafe or unsound practices.

Enforcement actions may include:

- the appointment of a conservator or receiver;
- the issuance of a cease and desist order;
- the termination of deposit insurance, the imposition of civil money penalties on the institution, its directors, officers, employees and institution affiliated parties;
- the issuance of directives to increase capital;
- the issuance of formal and informal agreements and orders;
- the removal of or restrictions on directors, officers, employees and institution-affiliated parties; and
- the enforcement of any such mechanisms through restraining orders or any other court actions.

We are subject to certain restrictions on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons which generally require that such credit extensions be made on substantially the same terms as are available to third persons dealing with us, and not involving more than the normal risk of repayment. Other laws tie the maximum amount that may be loaned to any one customer and its related interests to our capital levels. Other laws restrict or prohibit transactions between Peoples Bank and its affiliates.

#### *Limitations on Dividends and Other Payments*

Our ability to pay dividends is largely dependent upon the receipt of dividends from Peoples Bank. Both federal and state laws impose restrictions on our ability and the ability of Peoples Bank to pay dividends. Under such restrictions, Peoples Bank may only declare and pay dividends out of accumulated net earnings, including accumulated net earnings acquired as a result of a merger within seven years. Further, Peoples Bank may not declare or pay any dividends unless Peoples Bank's surplus would not be reduced by the payment of the dividend below 100% of our capital stock. Pennsylvania law requires that each year Peoples Bank set aside as surplus a sum equal to not less than 10 percent of its net earnings if surplus does not equal at least 100 percent of our capital stock. In addition to these specific restrictions, bank regulatory agencies, in general, also have the ability to prohibit proposed dividends by a financial institution that would otherwise be permitted under applicable regulations if the regulatory body determines that such distribution would constitute an unsafe or unsound practice.

#### *Permitted Non-Banking Activities*

A bank holding company that the FRB has determined to be well capitalized and well managed and that has well capitalized and well managed subsidiary banks may engage in certain nonbanking activities closely related to banking or managing or controlling banks, on a de novo basis, by providing notice to the FRB after commencing the activities. Such a bank holding company proposing to engage in other permissible nonbanking activities either de novo, or through the acquisition of an existing company, must provide prior notice to the FRB. For transactions that do not qualify for the post or expedited prior notice procedures, a bank holding company must file a notice for prior FRB approval.

Subsidiary banks of a bank holding company are subject to certain quantitative and qualitative restrictions on extensions of credit to the bank holding company or its subsidiaries, and on the use of their securities as collateral for loans to any borrower. These regulations and restrictions may limit our ability to obtain funds from Peoples Bank for our cash needs, including funds for the payment of dividends, interest and operating expenses. Further, subject to certain exceptions, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

A bank holding company is required to act as a source of financial strength to its subsidiary banks and to make capital injections into a troubled subsidiary bank, and the FRB may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank when required. A required capital injection may be called for at a time when the holding company does not have the resources to provide it. In addition, depository institutions insured by the FDIC can be held liable for any losses incurred by, or reasonably anticipated to be incurred by,



the FDIC in connection with the default of or assistance provided to, a commonly controlled FDIC-insured depository institution. Accordingly, in the event that any insured subsidiary of a bank holding company causes a loss to the FDIC, other insured subsidiaries of a bank holding company could be required to compensate the FDIC by reimbursing it for the estimated amount of such loss. Such cross guarantee liabilities generally are superior in priority to the obligation of the depository institutions to its shareholders due solely to their status as shareholders and obligations to other affiliates.

#### *Certain Transactions by Insured Banks with their Affiliates*

There are statutory restrictions related to the extent bank holding companies and their non-bank subsidiaries may borrow, obtain credit from or otherwise engage in “covered transactions” with their insured depository institution (i.e., banking) subsidiaries. In general, an “affiliate” of a bank includes the bank’s parent holding company and any subsidiary thereof. However, an “affiliate” does not generally include the bank’s operating subsidiaries. A bank (and its subsidiaries) may not lend money to, or engage in other covered transactions with, its non-bank affiliates if the aggregate amount of covered transactions outstanding involving the bank, plus the proposed transaction, exceeds the following limits: (a) in the case of any one such affiliate, the aggregate amount of covered transactions of the bank and its subsidiaries cannot exceed 10 percent of the bank’s capital stock and surplus; and (b) in the case of all affiliates, the aggregate amount of covered transactions of the bank and its subsidiaries cannot exceed 20 percent of the bank’s capital stock and surplus. “Covered transactions” are defined to include a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate, the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any person or company, the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate, securities borrowing or lending transactions with an affiliate that creates a credit exposure to such affiliate, or a derivatives transaction with an affiliate that creates a credit exposure to such affiliate. Certain covered transactions are also subject to collateral security requirements.

Covered transactions as well as other types of transactions between a bank and a bank holding company must be on market terms, which means that the transaction must be conducted on terms and under circumstances that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with or involving nonaffiliates or, in the absence of comparable transactions, that in good faith would be offered to or would apply to nonaffiliates. Moreover, certain amendments to the Bank Holding Company Act of 1956 provide that, to further competition, a bank holding company and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property of any kind, or furnishing of any service.

#### *Pennsylvania Law*

As a Pennsylvania incorporated bank holding company, Peoples is subject to various restrictions on its activities as set forth in Pennsylvania law. This is in addition to those restrictions set forth in federal law. Under Pennsylvania law, a bank holding company that desires to acquire a bank or bank holding company that has its principal place of business in Pennsylvania must obtain permission from the Department of Banking.

#### *Financial Institution Reform, Recovery, and Enforcement Act (“FIRREA”)*

FIRREA was enacted into law in order to address the financial condition of the Federal Savings and Loan Insurance Corporation, to restructure the regulation of the thrift industry, and to enhance the supervisory and enforcement powers of the federal bank and thrift regulatory agencies. As the primary federal regulator of Peoples Bank, the FDIC, in conjunction with the Department of Banking, is responsible for its supervision. When dealing with capital requirements, those regulatory bodies have the flexibility to impose supervisory agreements on institutions that fail to comply with regulatory requirements. The imposition of a capital plan, termination of deposit insurance, and removal or temporary suspension of an officer, director or other institution-affiliated person may cause enforcement actions.

There are three levels of civil penalties under FIRREA, with the amount of the penalty varying based on the action penalized.

These penalties are subject to inflation adjustment procedures prescribed under applicable law. Penalties for continuing violations can be substantially higher.

*Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”)*

FDICIA provides for, among other things:

- publicly available annual financial condition and management reports for financial institutions, including audits by independent accountants;
- the establishment of uniform accounting standards by federal banking agencies;
- the establishment of a “prompt corrective action” system of regulatory supervision and intervention, based on capitalization levels, with more scrutiny and restrictions placed on depository institutions with lower levels of capital;
- additional grounds for the appointment of a conservator or receiver; and
- restrictions or prohibitions on accepting brokered deposits, except for institutions which significantly exceed minimum capital requirements.

A central feature of FDICIA is the requirement that the federal banking agencies take “prompt corrective action” with respect to depository institutions that do not meet minimum capital requirements. Pursuant to FDICIA, the federal bank regulatory authorities have adopted regulations setting forth a five-tiered system for measuring the capital adequacy of the depository institutions that they supervise. Under these regulations, a depository institution is classified in one of the following capital categories:

- “well capitalized”;
- “adequately capitalized”;
- “under capitalized”;
- “significantly undercapitalized”; and
- “critically undercapitalized”.

Peoples Bank was “well capitalized” based on its actual capital position at December 31, 2021. However, an institution may be deemed by the regulators to be in a capitalization category that is lower than is indicated by its actual capital position if, among other things, it receives an unsatisfactory examination rating with respect to asset quality, management, earnings or liquidity.

FDICIA generally prohibits a depository institution from making any capital distributions including payment of a cash dividend or paying any management fees to its holding company, if the depository institution would thereafter be undercapitalized. Undercapitalized depository institutions are subject to growth limitations and are required to submit capital restoration plans. If a depository 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 other requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and stop accepting deposits from correspondent banks. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator; generally within 90 days of the date such institution is determined to be critically undercapitalized.

FDICIA provides the federal banking agencies with significantly expanded powers to take enforcement action against institutions that fail to comply with capital or other standards. Such actions may include the termination of deposit insurance by the FDIC or the appointment of a receiver or conservator for the institution. FDICIA also limits the circumstances under which the FDIC is permitted to provide financial assistance to an insured institution before appointment of a conservator or receiver.

Under FDICIA, each federal banking agency is required to prescribe, by regulation, non-capital safety and soundness standards for institutions under its authority. In addition to adopting information security standards, the federal banking agencies, including the FDIC, have adopted standards covering:

- internal controls;

- information systems and internal audit systems;
- loan documentation;
- credit underwriting;
- interest rate exposure;
- asset growth; and
- compensation fees and benefits.

Any institution that fails to meet these standards may be required to develop an acceptable plan, specifying the steps that the institutions will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. Peoples believes that it meets substantially all the standards that have been adopted. Before establishing new branch offices, Peoples Bank must meet certain minimum capital stock and surplus requirements and must obtain state approval from the Department of Banking.

#### *Risk-Based Capital Requirements*

The federal banking regulators have adopted certain risk-based capital guidelines to assist in assessing capital adequacy of a banking organization's operations for both transactions reported on the balance sheet as assets and transactions, such as letters of credit, and recourse agreements, which are recorded as off-balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit-equivalent amounts of off-balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. Treasury securities, to 150% for assets with relatively high credit risk, such as business loans.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk adjusted assets. The regulators measure risk-adjusted assets, which include off-balance-sheet items, against both total qualifying capital, Common Equity Tier 1 capital, and Tier 1 capital.

- "Common Equity Tier 1 Capital" includes common equity and minority interest in equity accounts of consolidated subsidiaries, less goodwill and other intangibles, subject to certain exceptions, and retained earnings.
- "Tier 1," or core capital, includes common equity, non-cumulative preferred stock and minority interest in equity accounts of consolidated subsidiaries, less goodwill and other intangibles, subject to certain exceptions.
- "Tier 2," or supplementary capital, includes, among other things, limited life preferred stock, hybrid capital instruments, mandatory convertible securities, qualifying subordinated debt, and the allowance for loan and lease losses, subject to certain limitations and less restricted deductions. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies.

Current rules, which implemented the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act, call for the following capital requirements:

- A minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5%;
- A minimum ratio of tier 1 capital to risk-weighted assets of 6%;
- A minimum ratio of total capital to risk-weighted assets of 8%; and
- A minimum leverage ratio of 4%.

In addition, the current rules provide for a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments.

Accumulated other comprehensive income ("AOCI") is included in a banking organization's common equity tier 1 capital. The rules, however, allowed community banks to make a one-time election not to include components of AOCI in regulatory capital and instead exclude most AOCI components from regulatory capital. Peoples Bank made that one-time election to "opt-out" of the inclusion of components of AOCI in regulatory capital.

Banking organizations may use the existing gross-up approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250 percent risk weight.

Mortgage servicing assets (“MSAs”) and certain deferred tax assets (“DTAs”) are subject to stricter limitations than those applicable to other assets under the capital rules.

Failure to meet applicable capital guidelines could subject a banking organization to a variety of enforcement actions including:

- limitations on its ability to pay dividends;
- the issuance by the applicable regulatory authority of a capital directive to increase capital, and in the case of depository institutions, the termination of deposit insurance by the FDIC, as well as to the measures described under FDICIA as applicable to undercapitalized institutions.

In addition, future changes in regulations or practices could further reduce the amount of capital recognized for purposes of capital adequacy. Such a change could affect the ability of Peoples Bank to grow and could restrict the amount of profits, if any, available for the payment of dividends to Peoples.

At December 31, 2021, Peoples met its capital requirements with a ratio of common equity tier 1 capital to risk-weighted assets of 13.76%; its ratio of tier 1 capital to risk-weighted assets of 13.76%; its ratio of total capital to risk-weighted assets of 15.01%; and its leverage ratio of 9.58%.

A qualifying community banking organization (defined to have, among other things, total consolidated assets of less than \$10 billion) that has made an election to use the community bank leverage ratio framework will be considered to have met the minimum capital requirements, the capital ratio requirements, and any other capital or leverage requirements to which the qualifying community banking organization would be subject, if it has a leverage ratio of greater than 9 percent. As of December 31, 2021, Peoples Bank has not elected to use the community bank leverage ratio framework.

#### *Interest Rate Risk*

Regulatory agencies include, in their evaluations of a bank’s capital adequacy, an assessment of the bank’s interest rate risk exposure. The standards for measuring the adequacy and effectiveness of a banking organization’s interest rate risk management includes a measurement of board of directors and senior management oversight, and a determination of whether a banking organization’s procedures for comprehensive risk management are appropriate to the circumstances of the specific banking organization. We utilize interest rate risk models to measure and monitor interest rate risk. In addition, we employ an independent consultant to provide a quarterly assessment of our interest rate risk. Finally, regulatory agencies, as part of the scope of their periodic examinations, evaluate our interest rate risk.

#### *Community Reinvestment Act (“CRA”)*

The Community Reinvestment Act of 1977 is designed to create a system for bank regulatory agencies to evaluate a depository institution’s record in meeting the credit needs of its community, including low and moderate-income neighborhoods. The CRA regulations establish performance-based standards for use in examining for compliance. Peoples Bank had its last CRA compliance examination in 2020 and received a “satisfactory” rating.

#### *USA Patriot Act of 2001 (the “Patriot Act”) and Anti-Money Laundering*

The Patriot Act contains anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. The federal Bank Secrecy Act (the “BSA”) also require financial institutions to, among other things, create a system of controls designed to prevent money laundering and the financing of terrorism, and imposes recordkeeping and reporting requirements. The Patriot Act enhanced regulations under the BSA to facilitate information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering, and requires financial institutions to establish anti-money laundering programs. Regulations adopted under the BSA impose on financial institutions customer due diligence requirements, and the federal banking agencies expect that customer due diligence programs will be integrated within a financial institution’s broader BSA and anti-money laundering compliance program. The Office of Foreign Assets Control (“OFAC”), a division of the U.S. Department of

the Treasury, is responsible for helping to ensure that domestic entities do not engage in transactions with “enemies” of the United States, as defined by various Executive Orders and Acts of Congress.

*Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)*

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Dodd-Frank is intended to effect a fundamental restructuring of federal banking regulation. Among other things, Dodd-Frank created the Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators authority to take control of and liquidate financial firms. Dodd-Frank additionally created an independent federal regulator to administer federal consumer protection laws. Dodd-Frank has and is expected to continue to have a significant impact on our business operations as its provisions take effect. Some of the rules that have been proposed and, in some cases, adopted to comply with Dodd-Frank’s mandates are discussed further below.

In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “EGRRCPA”) was enacted to reduce the regulatory burden on certain banking organizations, including community banks, by modifying or eliminating certain federal regulatory requirements. While the EGRRCPA maintains most of the regulatory structure established by Dodd-Frank, it amended certain aspects of the regulatory framework for small depository institutions with assets of less than \$10 billion as well as for larger banks with assets above \$50 billion. In addition, the EGRRCPA included regulatory relief for community banks regarding regulatory examination cycles, call reports, application of the Volcker Rule (proprietary trading prohibitions), mortgage disclosures, qualified mortgages, and risk weights for certain high-risk commercial real estate loans. Notwithstanding the relief from Dodd-Frank afforded by the EGRRCPA, federal banking regulators retain broad discretion to impose additional regulatory requirements on banking organizations based on safety and soundness and U.S. financial system stability considerations.

Among the provisions of Dodd-Frank that affect us are the following:

*Holding Company Capital Requirements.*  Dodd-Frank requires the FRB to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to depository institutions. Dodd-Frank additionally requires that bank regulators issue countercyclical capital requirements so that the required amount of capital increases in times of economic expansion, consistent with safety and soundness.

*Deposit Insurance.*  Dodd-Frank permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to \$250,000 per depositor. Dodd-Frank also broadens the base for FDIC insurance assessments. Further, Dodd-Frank eliminated the federal statutory prohibition against the payment of interest on business checking accounts. Assessments for institutions such as Peoples Bank (assets of less than \$10 billion), are based on initial assessment rates that are adjusted by combining supervisory ratings with financial ratios to determine a total assessment rate. For most institutions, assessment rates are based on weighted-average supervisory ratings of banking operation components and six financial ratios. The financial ratios are: the leverage ratio; loans past due 30-89 days/gross assets; nonperforming assets/gross assets; net loan charge-offs/gross assets; net income before taxes/risk-weighted assets; and the adjusted brokered deposit ratio. In addition, an institution’s assessment rate may be lowered if the institution holds long-term unsecured debt and raised if it holds long-term unsecured debt that is issued by another depository institution.

*Corporate Governance.*  Dodd-Frank requires publicly-traded companies to give stockholders a non-binding vote on executive compensation at least every three years, a non-binding vote regarding the frequency of the vote on executive compensation at least every six years, and a non-binding vote on “golden parachute” payments in connection with approvals of mergers and acquisitions unless previously voted on by stockholders. Additionally, Dodd-Frank directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets of \$1.0 billion or more, regardless of whether the company is publicly traded. Dodd-Frank also gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters. In 2016, the SEC and the federal banking regulators proposed rules to prohibit covered financial institutions (including bank holding companies and banks) from, among other things, establishing or maintaining incentive-based compensation arrangements that encourage inappropriate risk taking by providing covered persons (consisting of senior executive officers and significant risk takers, as defined in the rules) with excessive

compensation, fees or benefits that could lead to material financial loss to the financial institution. The comment period for these proposed rules has closed and a final rule has not yet been published.

*Limits on Interstate Acquisitions and Mergers.* Dodd-Frank precludes a bank holding company from engaging in an interstate acquisition—the acquisition of a bank outside its home state—unless the bank holding company is both well capitalized and well managed. Furthermore, a bank may not engage in an interstate merger with another bank headquartered in another state unless the surviving institution will be well capitalized and well managed.

*Limits on Interchange Fees.* Dodd-Frank amended the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets of \$10 billion or more and to enforce a statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. Issuers with less than \$10 billion in assets, like us, are exempt from debit card interchange fee standards.

*Consumer Financial Protection Bureau.* Dodd-Frank created the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB, but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

*Ability to Repay and Qualified Mortgage Rule.* Mortgage origination activities are subject to Regulation Z, which implements the federal Truth-in-Lending Act (“TILA”). Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers’ ability to repay in one of two ways. The first alternative requires the mortgage lender to consider, at a minimum, the following eight underwriting factors when making the credit decision:

- current or reasonably expected income or assets;
- current employment status;
- the monthly payment on the covered transaction;
- the monthly payment on any simultaneous loan;
- the monthly payment for mortgage-related obligations;
- current debt obligations, alimony, and child support;
- the monthly debt-to-income ratio or residual income; and
- credit history.

Alternatively, the mortgage lender can originate “qualified mortgages,” which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a “qualified mortgage” is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage, the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Loans which meet these criteria will be considered qualified mortgages, and as a result generally protect lenders from fines or litigation in the event of foreclosure. Qualified mortgages that are “higher-priced” (e.g. subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not “higher-priced” (e.g. prime loans) are given a safe harbor of compliance.



In addition to TILA and Regulation Z, mortgage origination activities are subject to the Equal Credit Opportunity Act, Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and Home Ownership Equity Protection Act, and the regulations promulgated under these acts, among other additional state and federal laws, regulations and rules.

#### *Federal Home Loan Bank of Pittsburgh*

Peoples Bank is a member of the Federal Home Loan Bank of Pittsburgh (“FHLB-Pgh”), which is one of 11 regional FHLBs that provide funding to their members for making housing loans as well as for affordable housing and community development loans. Each FHLB serves as a reserve, or central bank, for the members within its assigned region. Each FHLB makes loans to members in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member, each bank must purchase and maintain stock in the FHLB

#### *Brokered Deposits*

Section 29 of the Federal Deposit Insurance Act and FDIC regulations generally limit the ability of any bank to accept, renew or roll over any brokered deposit unless it is “well capitalized” or, with the FDIC’s approval, “adequately capitalized.” However, as a result of the EGRRCPA, the FDIC undertook a comprehensive review of its regulatory approach to brokered deposits, including reciprocal deposits, and interest rate caps applicable to banks that are less than “well capitalized.” On December 15, 2020, the FDIC issued final rules that amend the FDIC’s methodology for calculating interest rate caps, provide a new process for banks that seek FDIC approval to offer a competitive rate on deposits when the prevailing rate in the bank’s local market exceeds the national rate cap, and provides specific exemptions and streamlined application and notice procedures for certain deposit-placement arrangements that are not subject to brokered deposit restrictions. These final rules were effective on April 1, 2021.

#### *Cybersecurity*

The federal banking regulators have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution’s board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking agencies expect financial institutions to establish lines of defense and ensure that their risk management processes also address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution’s operations after a cyber-attack. In addition, all federal and state banking regulators continue to increase focus on cybersecurity programs and risks as part of regular supervisory exams.

On November 18, 2021, the federal banking regulators issued a final rule to improve the sharing of information about cyber incidents that may affect the U.S. banking system. The rule requires a banking organization to notify its primary federal regulator of any significant computer-security incident as soon as possible and no later than 36 hours after the banking organization determines that a cyber incident has occurred. Notification is required for incidents that have materially affected—or are reasonably likely to materially affect—the viability of a banking organization’s operations, its ability to deliver banking products and services, or the stability of the financial sector. In addition, the rule requires a bank service provider to notify affected banking organization customers as soon as possible when the provider determines that it has experienced a computer-security incident that has materially affected or is reasonably likely to materially affect banking organization customers for four or more hours. Compliance with the final rule is required by May 1, 2022.

#### *Future Legislation*

Proposed legislation is introduced in almost every legislative session that would dramatically affect the regulation of the banking industry. We cannot predict if any such legislation will be adopted nor if adopted how it would affect our business. Past history has demonstrated that new legislation or change to existing laws or regulations usually results in greater compliance burden and therefore generally increases the cost of doing business.

## Availability of Securities Filings

We maintain an Internet website at [www.psbtc.com](http://www.psbtc.com). We make available free of charge through the “Investor Relations” link on our Internet website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our internet website and the information contained therein are not incorporated into this Form 10-K. In addition, copies of our annual report will be made available, free of charge, upon written request.

## Item 1A. Risk Factors.

In addition to the other information set forth in this report, one should carefully consider the factors discussed below, which could materially affect our business, financial condition or future results. The risks described below are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be insignificant also may materially adversely affect our business, financial condition and/or operating results.

### Risks Relating to Peoples and Its Business

*The continuing coronavirus ("COVID-19") pandemic, or an outbreak of another highly infectious or contagious disease, has adversely affected our business and could have a more material adverse impact on our business activities, financial condition and results of operations.*

Our business is dependent upon the willingness and ability of our customers to conduct banking and other financial transactions. Since the beginning of January 2020, the COVID-19 outbreak has caused significant disruption in the financial markets both globally and in the United States. The continuing spread of COVID-19 and its Delta and Omicron variants, or an outbreak of another highly infectious or contagious disease, may result in a significant decrease in business and/or cause our customers to be unable to meet existing payment or other obligations to us, particularly in the event of a targeted spread of COVID-19 or an outbreak of an infectious disease in our market area. Although we maintain contingency plans for pandemic outbreaks, the continuing spread of COVID-19, or an outbreak of another contagious disease, could also negatively impact the availability of key personnel necessary to conduct our business activities. Such a spread or outbreak could also negatively impact the business and operations of third-party service providers who perform critical services for us. If COVID-19, or another highly infectious or contagious disease, spreads or the response to contain COVID-19 is unsuccessful, we could experience a material adverse effect to our business, financial condition, and results of operations.

We are continuing to monitor the COVID-19 crisis, including the emergence and impact of the Delta and Omicron variants, its economic effects and related risks, although the rapid development and fluidity of the situation precludes any specific prediction as to its ultimate impact. The extent of the impact of the COVID-19 pandemic on our capital, liquidity, and other financial positions and on our business, results of operations, and prospects will depend on a number of evolving factors, including:

The duration, extent, and severity of the pandemic, including the evolution of new COVID-19 variants, the impact related to the distribution and effectiveness of the available COVID-19 vaccines and treatments, and the potential development for additional vaccines and treatments in the future.

The response of governmental authorities. Many of the actions taken by the national and state governmental authorities have been directed at curtailing personal and business activity to contain COVID-19 while simultaneously deploying fiscal-and monetary-policy measures to assist in mitigating the adverse effects on individuals and businesses. These actions are not consistent across jurisdictions but, in general, have been rapidly expanding in scope and intensity.

The effect on our customers, counterparties, employees, and third-party service providers. COVID-19 and its associated consequences and uncertainties may affect individuals, households, and businesses differently and unevenly. Our credit, operational, and other risks are generally expected to increase.

The effect on economies and markets. Whether the actions of governmental authorities will be successful in mitigating the adverse effects of COVID-19 is unclear. National, regional, and local economies and markets could suffer lasting disruptions.

The success of relief efforts to bridge the gap to reopening the economy. The U.S. government has implemented programs to directly compensate individuals and grant or loan money to businesses in an effort to provide funding while the economy is shut down.

The duration of these business interruptions and related impacts on our business and operations, which will depend on future developments, are highly uncertain and cannot be reasonably estimated at this time. The pandemic could cause us to experience higher credit losses in our lending portfolio, impairment of our goodwill and other financial assets, reduced demand for our products and services, and other negative impacts on our financial position, results of operations, and prospects.

***We are subject to credit risk in connection with our lending activities, and our financial condition and results of operations may be negatively impacted by economic conditions and other factors that adversely affect our borrowers.***

Lending money is a significant part of the banking business and interest income on our loan portfolio is the principal component of our revenue. Our financial condition and results of operations are affected by the ability of our borrowers to repay their loans, and in a timely manner. Borrowers, however, do not always repay their loans. The risk of non-payment is assessed through our underwriting and loan review procedures based on several factors including credit risks of a particular borrower, changes in economic conditions, the duration of the loan and in the case of a collateralized loan, uncertainties as to the future value of the collateral and other factors. Despite our efforts, we do and will experience loan and lease losses, and our financial condition and results of operations will be adversely affected. Our loans which were between 30 and 89 days delinquent on December 31, 2021 totaled \$3.5 million. Our non-performing assets were approximately \$5.0 million on December 31, 2021. Our allowance for loan and lease losses was approximately \$28.4 million on December 31, 2021.

***Our emphasis on the Eastern Pennsylvania and the Southern Tier of New York market area exposes us to a risk of loss associated with the region.***

At December 31, 2021, \$297.6 million or 12.8%, of our loan portfolio consisted of residential mortgage loans and \$1.3 billion or 57.7%, of our loan portfolio consisted of commercial real estate loans. A majority of these loans are made to borrowers or secured by properties located in Eastern Pennsylvania and the southern tier of New York. Deterioration in economic conditions in this market area, particularly in the industries on which this geographic area depend, or a general decline in economic conditions may adversely affect the quality of our loan portfolio (including the level of non-performing assets, charge offs and provision for loan losses) and demand for our products and services, and, accordingly, our results of operations. Future declines in real estate values in the region could also cause some of our mortgage and commercial real estate loans to be inadequately collateralized, which would expose us to a greater risk of loss if we seek to recover on defaulted loans by selling the real estate collateral.

***We make commercial and industrial, construction, and commercial real estate loans, which present greater risks than other types of loans.***

As of December 31, 2021, approximately 87.0% of our loan portfolio consisted of commercial and industrial, construction, and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because our loan portfolio contains a significant number of commercial and industrial, construction, and commercial real estate loans some of which have large balances, the deterioration of one or a few of

these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses, and an increase in loan charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

The commercial real estate market is cyclical and poses risks of loss to us because of the concentration of commercial real estate loans in our loan portfolio, and the lack of diversity in risk associated with such a concentration. Banking regulators have been giving and continue to give commercial real estate lending greater scrutiny, and banks with larger commercial real estate loan portfolios are expected by their regulators to implement improved underwriting, internal controls, risk management policies and portfolio stress-testing practices to manage risks associated with commercial real estate lending. Additional losses or regulatory requirements related to our commercial real estate loan concentration could materially adversely affect our business, financial condition and results of operations.

***Our allowance for loan losses may not be adequate to absorb actual loan losses, and we may be required to make further provisions for loan losses and charge off additional loans in the future, which could materially and adversely affect our business.***

We attempt to maintain an allowance for loan losses, established through a provision for loan losses accounted for as an expense, which is adequate to absorb losses inherent in our loan portfolio. If our allowance for loan losses is inadequate, it may have a material adverse effect on our financial condition and results of operations.

The determination of the allowance for loan losses involves a high degree of subjectivity and judgment and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require us to increase our allowance for loan losses. Increases in non-performing loans have a significant impact on our allowance for loan losses. Our allowance for loan losses may not be adequate to absorb actual loan losses. If conditions in our regional real estate markets decline, we could experience increased delinquencies and credit losses, particularly with respect to real estate construction and land acquisition and development loans and one-to-four family residential mortgage loans. Moreover, if the economy slows, the negative impact to our market areas could result in higher delinquencies and credit losses. As a result, we will continue to make provisions for loan losses and to charge off additional loans in the future, which could materially adversely affect our financial conditions and results of operations.

In addition to our internal processes for determining loss allowances, bank regulatory agencies periodically review our allowance for loan losses and may require us to increase the provision for loan losses, to recognize further loan charge-offs, or to take other actions, based on judgments that differ from those of our management. If loan charge-offs in future periods exceed the allowance for loan losses, we will need to increase our allowance for loan losses. Furthermore, growth in our loan portfolio would generally lead to an increase in the provision for loan losses. Provisions for loan losses will result in a decrease in net income and capital, and may have a material adverse effect on our financial condition, and results of operations and cash flows.

***Changes in interest rates could adversely impact our financial condition and results of operations.***

Our ability to generate net income substantially depends upon our net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investment securities, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowings. Certain assets and liabilities react differently to changes in market interest rates. Further, interest rates on some types of assets and liabilities may fluctuate prior to changes in broader market interest rates, while rates on other types of assets may lag behind. Additionally, some assets such as adjustable-rate mortgages have features, and rate caps, which restrict changes in their interest rates.

Factors such as monetary policy, inflation, recession, unemployment, money supply, global disorder, terrorist activity, instability in domestic and foreign financial markets, global pandemic, and other factors beyond our control (including political, legal, and regulatory actions and policies in response to the military conflict between Russia and Ukraine), may affect interest rates. Changes in market interest rates will also affect the level of voluntary prepayments on loans and the

receipt of payments on mortgage-backed securities, resulting in the receipt of proceeds that may have to be reinvested at a lower rate than the loan or mortgage-backed security being prepaid. Although we pursue an asset-liability management strategy designed to manage our risk from changes in market interest rates, changes in interest rates can still have a material adverse effect on our profitability.

***The Company will be required to transition from the use of the LIBOR interest rate index in the future.***

The Company has certain loans and derivative instruments whose interest rate is indexed to the London InterBank Offered Rate (“LIBOR”). The LIBOR index will be discontinued for U.S. Dollar settings effective June 30, 2023. At this time, no consensus exists as to what reference rate or rates or benchmarks may become acceptable alternatives to LIBOR, although the Alternative Reference Rates Committee (a group of private-market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York) has identified the Secured Overnight Financing Rate, or SOFR, as the recommend alternative to LIBOR. Uncertainty as to the adoption, market acceptance or availability of SOFR or other alternative reference rates may adversely affect the value of LIBOR-based loans in the Company’s portfolio and may impact the availability and cost of hedging instruments and borrowings. The language in the Company’s LIBOR-based contracts and financial instruments has developed over time and may have various events that trigger when a successor index to LIBOR would be selected. If a trigger is satisfied, contracts and financial instruments may give the Company or the calculation agent, as applicable, discretion over the selection of the substitute index for the calculation of interest rates. The implementation of a substitute index for the calculation of interest rates under the Company’s loan agreements may result in the Company incurring significant expenses in effecting the transition and may result in disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute index, any of which could have an adverse effect on the Company’s results of operations.

***Changes in interest rates could affect our investment values and impact comprehensive income and stockholders’ equity.***

At December 31, 2021, we had approximately \$517.3 million of securities available-for-sale. These securities are carried at fair value on our consolidated balance sheets. Unrealized gains or losses on these securities, that is, the difference between the fair value and the amortized cost of these securities, are reflected in stockholders’ equity, net of deferred taxes. As of December 31, 2021, our available-for-sale securities had an unrealized loss, net of taxes, of \$1.4 million. The fair value of our available-for-sale securities is subject to interest rate change, which would not affect recorded earnings, but would increase or decrease comprehensive income and stockholders’ equity.

***Our results of operations may be materially and adversely affected by other-than-temporary impairment charges relating to our investment portfolio.***

Numerous factors, including the lack of liquidity for re-sales of certain investment securities, the absence of reliable pricing information for investment securities, adverse changes in the business climate, adverse regulatory actions or unanticipated changes in the competitive environment, could have a negative effect on our investment portfolio in future periods. Investments are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term “other than temporary” indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment.

Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. If an impairment charge is significant enough, it could affect our ability to pay dividends, which could materially adversely affect us and our ability to pay dividends to shareholders. Significant impairment charges could also negatively impact our regulatory capital ratios and result in us not being classified as “well-capitalized” for regulatory purposes.

***The requirement to record certain assets and liabilities at fair value may adversely affect our financial results.***

We report certain assets, including available-for-sale investment securities, at fair value. Generally, for assets that are reported at fair value we use quoted market prices or valuation models that utilize market data inputs to estimate fair value. Because we record these assets at their estimated fair value, we may incur losses even if the asset in question presents minimal credit risk. The level of interest rates can impact the estimated fair value of investment securities. Disruptions in the capital markets may require us to recognize other-than-temporary impairments in future periods with respect to investment securities in our portfolio. The amount and timing of any impairment recognized will depend on the severity and duration of the decline in fair value of our investment securities and our estimation of the anticipated recovery period.

***Changes in the value of goodwill and intangible assets could reduce our earnings.***

We account for goodwill and other intangible assets in accordance with accounting principles generally accepted in the United States of America (“GAAP”), which, in general, requires that goodwill not be amortized, but rather that it be tested for impairment at least annually at the reporting unit level using the two step approach. Testing for impairment of goodwill and intangible assets is performed annually, or more frequently if market factors change, and involves the identification of reporting units and the estimation of fair values. The estimation of fair values involves a high degree of judgment and subjectivity in the assumptions used. At December 31, 2021, we completed a qualitative goodwill impairment test to determine if it is more likely than not (that is, a likelihood of more than 50%) that the fair value of the Company is less than its carrying value, including goodwill, as described by the GAAP methodology. Based on this analysis, we concluded it is more likely than not that the fair value of the Company, as of December 31, 2021, is higher than its carrying value, and, therefore, goodwill is not considered impaired and no further testing is required. Changes in the local and national economy, the federal and state legislative and regulatory environments for financial institutions, the stock market, interest rates and other external factors (such as global pandemics or natural disasters) may occur from time to time, often with great unpredictability, and may materially impact the fair value of publicly traded financial institutions and could result in an impairment charge at a future date.

***Changes in U.S. or regional economic conditions could have an adverse effect on the Company’s business, financial condition and results of operations.***

The Company’s business activities and earnings are affected by general business conditions in the United States and in the market areas the Company operates. These conditions include short-term and long-term interest rates, inflation, unemployment levels, consumer confidence and spending, fluctuations in both debt and equity capital markets, and the strength of the economy in the United States generally and, in particular, the Company’s market area. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, low unemployment, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment; global pandemics, natural disasters; or a combination of these or other factors. Economic pressure on consumers and uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and savings habits. Elevated levels of unemployment, declines in the values of real estate, extended federal government shutdowns, or other events that affect household and/or corporate incomes could impair the ability of the Company’s borrowers to repay their loans in accordance with their terms and reduce demand for banking products and services.

***Strong competition within our market area may limit our growth and profitability.***

Competition in the banking and financial services industry is intense. We compete actively with other Pennsylvania, New Jersey and New York financial institutions, many larger than us, as well as with financial and non-financial institutions headquartered elsewhere. Commercial banks, savings banks, savings and loan associations, credit unions, and money market funds actively compete for deposits and loans. Such institutions, as well as consumer finance, insurance companies and brokerage firms, may be considered competitors with respect to one or more services they



render. Many of the institutions with which we compete have substantially greater resources and lending limits and may offer certain services that we do not or cannot provide. Our profitability depends upon our ability to successfully compete in our market area.

***Increased needs for disbursement of funds on loans and deposits can affect our liquidity.***

We manage our liquidity with an objective of maintaining a balance between sources and uses of funds in such a way that the cash requirements of customers for loans and deposit withdrawals are met in the most economical manner. If we do not properly manage our liquidity, our business, financial condition, results of operations and cash flows may be materially and adversely affected.

***Our future pension plan costs and contributions could be unfavorably impacted by the factors that are used in the actuarial calculations.***

We maintain a non-contributory defined benefit pension plan, which was frozen in 2008. The costs for this legacy pension plan are dependent upon a number of factors, such as the rates of return on plan assets, discount rates, the level of interest rates used to measure the required minimum funding levels of the plans, future government regulation and required or voluntary contributions made to the plans. Without sustained growth in the pension investments over time to increase the value of our plan assets and depending upon the other factors impacting net income as listed above, we could be required to fund the plan with higher amounts of cash than are anticipated by our actuaries. Such increased funding obligations could have a material impact on our liquidity by reducing our cash flows.

***Our holding company is dependent for liquidity on payments from Peoples Bank, which payments are subject to restrictions.***

We depend on dividends, distributions and other payments from Peoples Bank to fund dividend payments to our shareholders, if any, and to fund all payments on obligations of our holding company. Peoples Bank is subject to laws that restrict dividend payments or authorize regulatory bodies to block or reduce the flow of funds from Peoples Bank to us. Restrictions or regulatory actions of that kind could impede our access to funds that we may need to make payments on our obligations or dividend payments, if any. In addition, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. Holders of our common stock are entitled to receive dividends if and when declared from time to time by our board of directors in its sole discretion out of funds legally available for that purpose.

***We need to continually attract and retain qualified personnel for our operations.***

Our ability to provide high-quality customer service and to operate efficiently and profitably is dependent on our ability to attract and retain qualified individuals for key positions within the organization. We rely heavily on our executive officers and employees. The loss of certain executive officers or employees could have an adverse effect on us because, as a community bank, the executive officers and employees typically have more responsibility than would be typical at a larger financial institution with more employees. In addition, due to our size as a community bank, we have fewer management-level and other personnel who are in position to succeed to and assume the responsibilities of certain existing executive officers and employees. If we expand geographically or expand to provide non-banking services, current management may not have the necessary experience for successful operation in these new areas. There is no guarantee that management would be able to meet these new challenges or that we would be able to retain new officers or personnel with the appropriate background and expertise.

***Our financial performance may suffer if our information technology is unable to keep pace with growth or industry developments.***

Effective and competitive delivery of our products and services is increasingly dependent upon information technology resources and processes, both those provided internally as well as those provided through third party vendors. In addition to better serving customers, the effective use of technology increases efficiency and enables us to reduce costs. Our

future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services to enhance customer convenience, as well as to create additional efficiencies in our operations. Many of our competitors have greater resources to invest in technological improvements. Additionally, as technology in the financial services industry changes and evolves, keeping pace becomes increasingly complex and expensive for us. There can be no assurance that we will be able to effectively implement new technology-driven products and services, which could reduce our ability to compete effectively.

***A failure in or a breach of our information systems or infrastructure, including as a result of cyber-attacks, could disrupt our business, damage our reputation, and could have a material adverse effect on our business, financial condition and results of operations.***

In the ordinary course of our business activities, including the ongoing maintenance of deposits, loan and other account relationships for our customers, receiving instructions and effecting transactions for those customers and other users of our products and services, we regularly collect, process, transmit and store significant amounts of confidential information regarding our customers, employees and others. In addition to confidential information regarding our customers, employees and others, we, and in some cases a third party, compile, process, transmit and store proprietary, non-public information concerning our business, operations, plans and strategies.

Information security risks have significantly increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties. We rely on digital technologies, computer and email systems, software, and networks to conduct secure processing, transmission and storage of confidential information. In addition, to access our products and services, our customers may use personal smart phones, tablet PCs and other mobile devices that are beyond our control systems. Our technologies, systems, networks and our customers' devices have been subject to, and are likely to continue to be the target of, cyber-attacks, computer viruses, malicious code, phishing attacks or information security breaches that could result in the unauthorized use, loss or destruction of our or our customers' or third parties' confidential information, or otherwise disrupt our or our customers' or other third parties' business operations.

In addition to cyber-attacks or other security breaches involving the theft of sensitive and confidential information, hackers have engaged in attacks against large financial institutions, particularly denial of service attacks, that are designed to disrupt key business services, such as customer-facing web sites. We are not able to anticipate or implement effective preventive measures against all security breaches of these types, especially because the techniques used change frequently and because attacks can originate from a wide variety of sources.

Although we use a variety of physical, procedural and technological safeguards to protect confidential information from mishandling, misuse or loss, these safeguards cannot provide assurance that mishandling, misuse or loss of the information will not occur, and that if mishandling, misuse or loss of the information did occur, those events will be promptly detected and addressed. A failure in or breach of our operational or information security systems, or those of a third-party service provider, as a result of cyber-attacks or information security breaches or otherwise could have a material adverse effect on our business, damage our reputation, increase our costs and/or cause significant losses. As information security risks and cyber threats continue to evolve, we may be required to expend substantial resources to further enhance our information security measures and/or to investigate and remediate any information security vulnerabilities.

If information security is breached, despite the controls we and our third-party vendors have instituted, information can be lost or misappropriated, resulting in financial loss or costs to us or damages to others. These costs or losses could materially exceed the amount of insurance coverage, if any, which would adversely affect our earnings. In addition, our reputation could be damaged which could result in loss of customers, greater difficulty in attracting new customers, or an adverse effect on the value of our common stock.

***Our disclosure controls and procedures and our internal control over financial reporting may not achieve their intended objectives.***

We maintain disclosure controls and procedures designed to ensure that we timely report information as specified in the rules and forms of the Securities and Exchange Commission (“SEC”). We also maintain a system of internal control over financial reporting. These controls may not achieve their intended objectives. Control processes that involve human diligence and compliance, such as our disclosure controls and procedures and internal control over financial reporting, are subject to lapses in judgment and breakdowns resulting from human failures. Controls can also be circumvented by collusion or improper management override. Because of such limitations, there are risks that material misstatements due to error or fraud may not be prevented or detected and that information may not be reported on a timely basis. If our controls are not effective, it could have a material adverse effect on our financial condition, results of operations, and market for our common stock, and could subject us to regulatory scrutiny.

***We are exposed to environmental liabilities with respect to real estate.***

We currently operate 28 branch offices, and own additional real estate. In addition, a significant portion of our loan portfolio is secured by real property. In the course of our business, we may foreclose, accept deeds in lieu of foreclosure, or otherwise acquire real estate, and in doing so could become subject to environmental liabilities with respect to these properties. We may become responsible to a governmental agency or third parties for property damage, personal injury, investigation and clean-up costs incurred by those parties in connection with environmental contamination, or may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with environmental investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. Although we have policies and procedures to perform an environmental review before acquiring title to any real property, these may not be sufficient to detect all potential environmental hazards. If we were to become subject to significant environmental liabilities, it could materially and adversely affect us.

***The soundness of other financial services institutions may adversely affect our credit risk.***

We rely on other financial services institutions through trading, clearing, counterparty, and other relationships. We maintain limits and monitor concentration levels of our counterparties as specified in our internal policies. Our reliance on other financial services institutions exposes us to credit risk in the event of default by these institutions or counterparties. These losses could adversely affect our results of operations and financial condition.

***Our operations could be interrupted if certain external vendors on which we rely experience difficulty, terminate their services or fail to comply with applicable laws and regulations.***

We depend to a significant extent on relationships with third party service providers. Specifically, we utilize third party core banking services and receive credit card and debit card services, branch capture services, Internet banking services and services complementary to our banking products from various third party service providers. If these third party service providers experience difficulties or terminate their services and we are unable to replace them with other service providers, our operations could be interrupted. It may be difficult for us to replace some of our third party vendors, particularly vendors providing our core banking, credit card and debit card services, in a timely manner if they were unwilling or unable to provide us with these services in the future for any reason. If an interruption were to continue for a significant period of time, it could have a material adverse effect on our business, financial condition or results of operations. Even if we are able to replace them, it may be at higher cost to us, which could have a material adverse effect on our business, financial condition or results of operations. In addition, if a third party provider fails to provide the services we require, fails to meet contractual requirements, such as compliance with applicable laws and regulations, or

suffers a cyber-attack or other security breach, our business could suffer economic and reputational harm that could have a material adverse effect on our business, financial condition or results of operations.

***Our use of third party vendors and our other ongoing third party business relationships are subject to regulatory requirements and attention.***

We regularly use third party vendors as part of our business. We also have substantial ongoing business relationships with other third parties. These types of third party relationships are subject to demanding regulatory requirements and attention by our bank regulators. Banking regulations requires us to perform due diligence, ongoing monitoring and maintain control over our third party vendors and other ongoing third party business relationships. We expect that our regulators will hold us responsible for deficiencies in our oversight and control of our third party relationships and in the performance of the parties with which we have these relationships. As a result, if our regulators conclude that we have not exercised adequate oversight and control over our third party vendors or other ongoing third party business relationships or that such third parties have not performed appropriately, we could be subject to enforcement actions, including civil money penalties or other administrative or judicial penalties or fines as well as requirements for customer remediation, any of which could have a material adverse effect on our business, financial condition or results of operations.

**Risks Related to Our Common Stock**

***Our ability to pay dividends or repurchase shares is subject to limitations.***

Our ability to pay dividends on or repurchase shares of our stock depends upon our receipt of dividends from Peoples Bank. Additionally, our ability to pay dividends is limited by Pennsylvania corporate law and by federal banking regulations. Under Pennsylvania law, we may not pay a dividend if, after payment, we could not pay our debts as they become due in the usual course of business or our total assets would be less than our total liabilities. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company's capital needs, asset quality and overall financial condition.

As a state-chartered bank, Peoples Bank is subject to regulatory restrictions on the payment and amounts of dividends under the Pennsylvania Banking Code. Further, Peoples Bank's ability to pay dividends is also subject to its profitability, financial condition, capital expenditures and other cash flow requirements. There is no assurance that Peoples Bank will be able to pay dividends. Our failure to pay dividends could have a material adverse effect on the market price of our common stock.

***Proxy contests and shareholder litigation may adversely affect our results of operations.***

Proxy contests or shareholder litigation could cause us to use resources, both in expense and in the time and attention of our management, which could otherwise be used in operating our business. Accordingly, our results of operations may be adversely effected.

**Risks Related to Potential Future Transactions**

***Future acquisitions by us could dilute existing shareholders' ownership of Peoples and may cause us to become more susceptible to adverse economic events.***

We may issue shares of our common stock in connection with future acquisitions and other investments, which would dilute existing shareholders' ownership interests in Peoples. While there is no assurance that these transactions will occur, or that they will occur on terms favorable to us, future business acquisitions could be material to us, and the degree of success achieved in acquiring and integrating these businesses could have a material effect on the value of our common stock. In addition, these acquisitions could require us to expend substantial cash or other liquid assets or to incur debt, which could cause us to become more susceptible to economic downturns and competitive pressures.

***Our governing documents, Pennsylvania law, and current policies of our board of directors contain provisions which may reduce the likelihood of a change in control transaction that may otherwise be available and attractive to shareholders.***

Our articles of incorporation and bylaws contain certain anti-takeover provisions that may make it more difficult or expensive or may discourage a tender offer, change in control or takeover attempt that is opposed by our board of directors. In particular, the articles of incorporation and bylaws: classify our board of directors into three groups, so that shareholders elect only approximately one-third of the board each year; require our shareholders to give us advance notice to nominate candidates for election to the board of directors or to make shareholder proposals at a shareholders' meeting; and require the affirmative vote of the holders of at least 75% of our common stock to approve amendments to our bylaws or to approve certain business combinations that have not received the support of two-thirds of our board of directors. These provisions of our articles of incorporation and bylaws could discourage potential acquisition proposals and could delay or prevent a change in control, even though a majority of our shareholders may consider such proposals desirable. Such provisions could also make it more difficult for third parties to remove and replace the members of our board of directors. Moreover, these provisions could diminish the opportunities for shareholders to participate in certain tender offers, including tender offers at prices above the then-current market value of our common stock, and may also inhibit increases in the trading price of our common stock that could result from takeover attempts or speculation.

In addition, anti-takeover provisions in Pennsylvania law could make it more difficult for a third party to acquire control of us. These provisions could adversely affect the market price of our common stock and could reduce the amount that shareholders might receive if we are sold. For example, Pennsylvania law may restrict a third party's ability to obtain control of Peoples and may prevent shareholders from receiving a premium for their shares of our common stock. Pennsylvania law also provides that our shareholders are not entitled by statute to propose amendments to our articles of incorporation.

***Our ability to make opportunistic acquisitions is subject to significant risks, including the risk that regulators will not provide the requisite approvals.***

We may make opportunistic whole or partial acquisitions of other banks, branches, financial institutions, or related businesses from time to time that we expect may further our business strategy. Any possible acquisition will be subject to regulatory approval, and there can be no assurance that we will be able to obtain such approval in a timely manner or at all. Even if we obtain regulatory approval, these acquisitions could involve numerous risks, including lower than expected performance or higher than expected costs, difficulties related to integration, diversion of management's attention from other business activities, changes in relationships with customers, and the potential loss of key employees. In addition, we may not be successful in identifying acquisition candidates, integrating acquired institutions, or preventing deposit erosion or loan quality deterioration at acquired institutions. Competition for acquisitions can be highly competitive, and we may not be able to acquire other institutions on attractive terms. There can be no assurance that we will be successful in completing or will even pursue future acquisitions, or if such transactions are completed, that we will be successful in integrating acquired businesses into operations. Our ability to grow may be limited if we choose not to pursue or are unable to successfully make acquisitions in the future.

### **Risks Related to Government Regulation**

***We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations.***

We are subject to extensive regulation, supervision and examination by certain state and federal agencies including the FDIC, the Federal Reserve Board and the Pennsylvania Department of Banking. Such regulation and supervision govern the activities in which we may engage and are intended primarily to ensure the safety and soundness of financial institutions. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of assets and determination of the level of the allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on us and our operations. There also are several federal and state statutes which regulate the obligation and liabilities of financial institutions pertaining to environmental issues. In addition to the potential for attachment of liability resulting from our own actions, we may be held liable under certain

circumstances for the actions of our borrowers, or third parties, when such actions result in environmental problems on properties that collateralize loans held by us. Further, the liability has the potential to far exceed the original amount of a loan.

***We may be subject to more stringent capital and liquidity requirements in the future, which may adversely affect our net income and future growth.***

Future increases, if any, in minimum capital requirements could adversely affect our net income. Furthermore, our failure to comply with the minimum capital requirements could result in our regulators taking formal or informal actions against us which could restrict our future growth or operations.

***The regulations issued by the CFPB have increased and may continue to increase our costs of operations.***

The CFPB has broad powers to supervise and enforce consumer protection laws and broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB considers whether additional rules are needed and has direct examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks with \$10 billion or less in assets, like us, are examined for compliance with these consumer laws by their primary bank regulators. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

***Increases in FDIC insurance premiums may adversely affect our earnings.***

Our deposits are insured by the FDIC up to legal limits and, accordingly, we are subject to FDIC deposit insurance assessments. Should our supervisory rating be lowered or our unsecured debt increase, we may be required to pay an increased assessment. More generally, should the designated reserve ratio of the FDIC Deposit Insurance Fund be raised or the fund suffer losses, we may be required to pay an increased assessment. An increase in the assessment we pay may adversely impact our earnings.

***Regulations relating to privacy, information security and data protection could increase our costs, affect or limit how we collect and use personal information and adversely affect our business opportunities.***

We are subject to various privacy, information security and data protection laws, including requirements concerning security breach notification, and we could be negatively impacted by these laws. For example, our business is subject to the Gramm-Leach-Bliley Act which, among other things: (i) imposes certain limitations on our ability to share nonpublic personal information about our customers with nonaffiliated third parties; (ii) requires that we provide certain disclosures to customers about our information collection, sharing and security practices and afford customers the right to “opt out” of any information sharing by us with nonaffiliated third parties (with certain exceptions) and (iii) requires that we develop, implement and maintain a written comprehensive information security program containing safeguards appropriate based on our size and complexity, the nature and scope of our activities, and the sensitivity of customer information we process, as well as plans for responding to data security breaches. Various state and federal banking regulators and states have also enacted data security breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Moreover, legislators and regulators in the United States are increasingly adopting or revising privacy, information security and data protection laws that potentially could have a significant impact on our current and planned privacy, data protection and information security-related practices, our collection, use, sharing, retention and safeguarding of consumer or employee information, and some of our current or planned business activities. This could also increase our costs of compliance and business operations and could reduce income from certain business initiatives. This includes increased privacy-related enforcement activity at the federal level, by the Federal Trade Commission, as well as at the state level, such as with regard to mobile applications.

Compliance with current or future privacy, data protection and information security laws (including those regarding security breach notification) affecting customer or employee data to which we are subject could result in higher compliance and technology costs and could restrict our ability to provide certain products and services, which could have a material adverse effect on our business, financial conditions or results of operations. Our failure to comply with privacy, data protection and information security laws could result in potentially significant regulatory or governmental

investigations or actions, litigation, fines, sanctions, increased insurance cost and damage to our reputation, which could have a material adverse effect on our business, financial condition or results of operations.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

Our corporate headquarters is located at 150 N. Washington Avenue, Scranton, Pennsylvania, which houses our finance and planning, trust, commercial lending, human resources and investor services divisions, as well as our executive offices. Our operations division is located at 82 Franklin Avenue, Hallstead, Pennsylvania.

We operate 28 full-service community banking offices located within the Allegheny, Bucks, Lackawanna, Lebanon, Lehigh, Luzerne, Monroe, Montgomery, Northampton, Susquehanna and Wyoming Counties of Pennsylvania, Middlesex County of New Jersey and Broome County of New York. Nine offices are leased and the balance are owned by Peoples Bank.

We lease several remote ATM locations throughout our market area. All branches and ATM locations are equipped with closed circuit television monitoring.

We consider our properties to be suitable and adequate for our current and immediate future purposes.

**Item 3. Legal Proceedings.**

There are no material pending legal proceedings, other than ordinary routine litigation incidental to our business, as to which we are a party or of which any of our property is subject.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Part II**

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

As of February 28, 2022 there were approximately 3,794 holders of our common stock, \$2.00 par value, including individual participants in security position listings. Our common stock trades on The Nasdaq Stock Market under the symbol "PFIS."

Peoples has paid cash dividends since its incorporation in 1986. It is the present intention of the Board of Directors to continue to pay quarterly cash dividends; however, the payment of future dividends must necessarily depend upon earnings, financial position, appropriate restrictions under applicable laws and other factors relevant at the time our board of directors considers any declaration of dividends. The Board declared on January 28, 2022 a first quarter dividend of \$0.39 per share payable March 15, 2022. For information on dividend restrictions on the Company and Peoples Bank, refer to Part I, Item 1 "Supervision and Regulation – Limitations on Dividends and Other Payments" to this report and refer to the consolidated financial statements and notes to these statements filed at Item 8 to this report and incorporated in their entirety by reference under this Item 5.



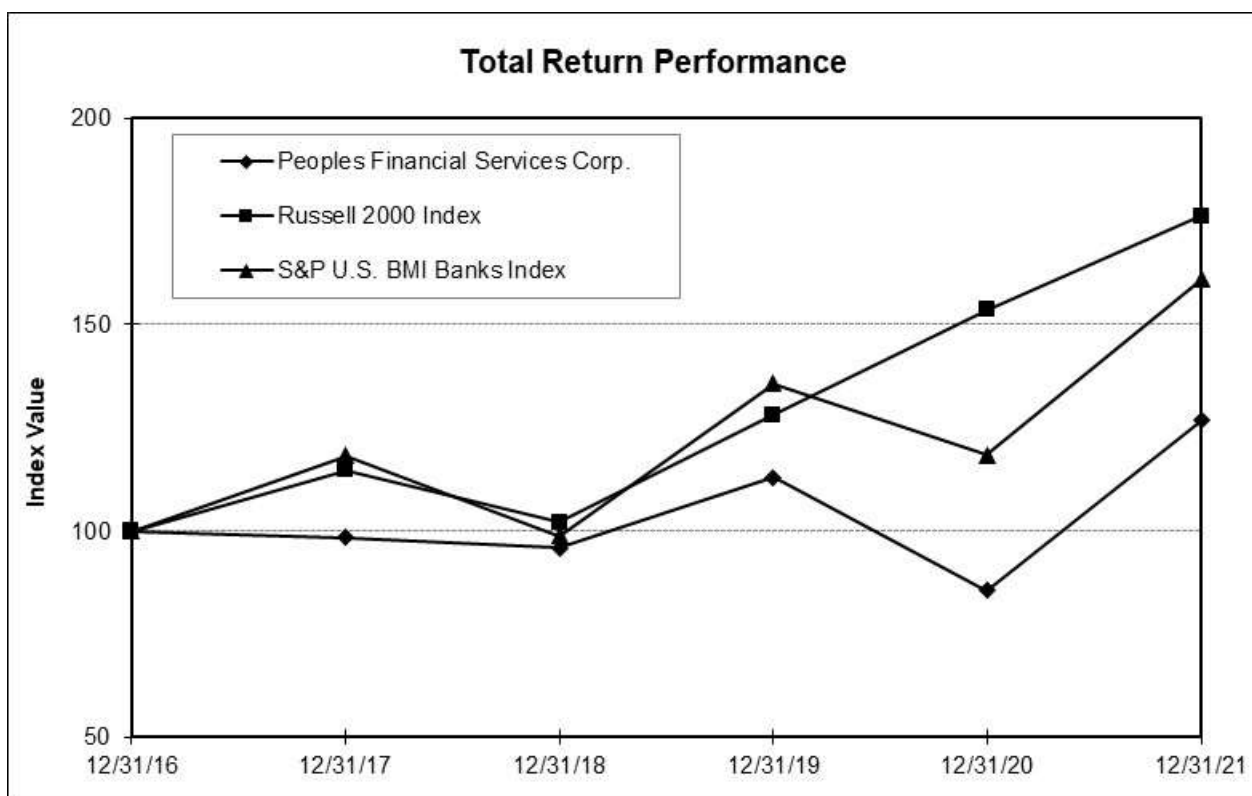
The following table presents information with respect to purchases made by or on behalf of the Company or any “affiliated purchaser,” as defined in the Exchange Act Rule 10b-18(a)(3), of the Company’s common stock during each of the three months ended December 31, 2021:

<b>Month Ending</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Programs</b>	<b>Maximum Number of Shares that may yet be Purchased Under the Programs</b>
October 31, 2021	4,306	\$ 45.93	246,962	304,988
November 30, 2021	215	47.50	247,177	304,773
December 31, 2021	3,136	\$ 47.94	250,313	301,637

On February 28, 2020, our board of directors authorized a common stock repurchase plan whereby we were authorized to repurchase up to 225,000 shares of our outstanding common stock through open market purchases. That plan expired on December 31, 2020. On January 29, 2021, our board of directors authorized a new common stock repurchase plan whereby we are authorized to repurchase up to 353,422 shares of our outstanding common stock.

The following graph and table show the cumulative total return on the common stock of the Company over the last five years, compared with the cumulative total return of a broad stock market index (the Russell 2000 Index or “Russell 2000”), and the S&P U.S. BMI Banks Index. The cumulative total return on the stock or the index equals the total increase in value since December 31, 2016, assuming reinvestment of all dividends paid into the stock or the index. The graph and table were prepared assuming that \$100 was invested on December 31, 2016, in the common stock and the securities included in the indexes.

**Comparison of Five-Year Cumulative Total Returns**  
 Performance Graph of  
 PEOPLES FINANCIAL SERVICES CORP



<i>Index</i>	<i>Period Ending</i>					
	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021
Peoples Financial Services Corp.	100.00	98.48	95.93	113.02	85.56	126.79
Russell 2000 Index	100.00	114.65	102.02	128.06	153.62	176.39
S&P U.S. BMI Banks Index	100.00	118.21	98.75	135.64	118.33	160.89

Source: S&P Global Market Intelligence  
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**Item 6. Reserved.**

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

**Management’s Discussion and Analysis 2021 versus 2020  
(Dollars in thousands, except per share data)**

Management’s Discussion and Analysis appearing on the following pages should be read in conjunction with the Consolidated Financial Statements and Management’s Discussion and Analysis 2020 versus 2019 contained in this Annual Report on Form 10-K.

**Forward-Looking Discussion:**

In addition to the historical information contained in this document, the discussion presented may contain and, from time to time, may make, certain statements that constitute forward-looking statements. Words such as “expects,” “anticipates,” “believes,” “estimates” and other similar expressions or future or conditional verbs such as “should,” “would” and “could” are intended to identify such forward-looking statements. These statements are not historical facts, but instead represent the current expectations, plans or forecasts of Peoples Financial Services Corp. and its subsidiaries regarding its future operating results, financial position, asset quality, credit reserves, credit losses, capital levels, dividends, liquidity, service charges, cost savings, effective tax rate, impact of changes in fair value of financial assets and liabilities, impact of new accounting and regulatory guidance, legal proceedings and other matters relating to us and the securities that we may offer from time to time. These statements are not guarantees of future results or performance and involve certain risks, uncertainties and assumptions that are difficult to predict, change over time and are often beyond our control. Actual outcomes and results may differ materially from those expressed in, or implied by, forward-looking statements.

You should not place undue reliance on any forward-looking statement and should consider the uncertainties and risks discussed in the “Risk Factors” in Part I, Item 1A of this Annual Report, among others, and in any of our subsequent SEC filings. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statement to reflect the impact of circumstances or events that arise after the date the forward-looking statement was made. Notes to the Consolidated Financial Statements referred to in the Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) are incorporated by reference into the MD&A. Certain prior period amounts have been reclassified to conform with the current year’s presentation.

**Critical Accounting Estimates:**

Our consolidated financial statements are prepared in accordance with GAAP. The preparation of consolidated financial statements in conformity with GAAP requires us to establish critical accounting policies and make accounting estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during those reporting periods.

An accounting estimate requires assumptions about uncertain matters that could have a material effect on the consolidated financial statements if a different amount within a range of estimates were used or if estimates changed from period to period. Readers of this report should understand that estimates are made considering facts and circumstances at a point in time, and changes in those facts and circumstances could produce results that differ from when those estimates were made. Significant estimates that are particularly susceptible to material change within the near term relate to the determination of allowance for loan losses, and the impairment of goodwill. Actual amounts could differ from those estimates.

We maintain the allowance for loan losses at a level we believe adequate to absorb probable credit losses related to individually evaluated loans, as well as probable incurred losses inherent in the remainder of the loan portfolio as of the balance sheet date. The balance in the allowance for loan losses account is based on past events and current economic conditions among other things.

The allowance for loan losses account consists of an allocated element and an unallocated element. The allocated element consists of a specific portion for the impairment of loans individually evaluated and a formula portion for loss contingencies on those loans collectively evaluated. The unallocated element, if any, is used to cover inherent losses that exist as of the evaluation date, but which have not been identified as part of the allocated allowance using our impairment evaluation methodology due to limitations in the process.

We monitor the adequacy of the allocated portion of the allowance quarterly and adjust the allowance as necessary through normal operations. This ongoing evaluation reduces potential differences between estimates and actual observed losses. The determination of the level of the allowance for loan losses is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Accordingly, management cannot ensure that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the allowance for loan losses will not be required, resulting in an adverse impact on operating results.

Goodwill is evaluated at least annually for impairment or more frequently if conditions indicate potential impairment exist. Any impairment losses arising from such testing are reported in the income statement in the current period as a separate line item within operations.

For a further discussion of our critical accounting estimates, refer to Note 1 entitled, “Summary of significant accounting policies,” in the Notes to Consolidated Financial Statements to this Annual Report. Note 1 lists the significant accounting policies used by us in the development and presentation of the consolidated financial statements. This discussion and analysis, the Notes to Consolidated Financial Statements and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for the understanding and evaluation of our financial position, results of operations and cash flows.

#### **Operating Environment:**

Market yields rose rapidly to start 2022, despite signs the economy stuttered amid the COVID-19 Omicron outbreak, as inflation pressures remained firm and amid a number of Federal Open Market Committee (“FOMC”) members’ commentary. Minutes from the Federal Reserve Board’s late-December meeting indicated officials believed Omicron would temporarily impact the economy but would not change the overall trajectory of the recovery. Those minutes also showed officials believed that the labor market would continue its rapid progress towards full employment, with inflation already at its highest levels in decades. The hiring in December’s nonfarm payroll report disappointed expectations but the data provided support for the Federal Reserve Board’s analysis that the labor market is becoming increasingly tight. Participation was flat at 61.9%, 1.5% points below its pre-pandemic level, while unemployment dropped much further than expected from 4.2% to 3.9%, 0.1% below the Federal Reserve Board’s estimate of full employment. Adding to evidence of a tight labor market, average hourly earnings rose firmly again and were 4.7% higher than a year ago.

December’s Consumer Price Index (“CPI”) report was a bit hotter than expected on a monthly basis, pushing the annual headline rate up to 7.0%, the fastest since 1982, and the core rate to 5.5%, its strongest gain since 1991. The Federal Reserve Board’s preferred measure, the core PCE price index (defined as personal consumption expenditures excluding food and energy), accelerated from 4.7% to 4.9%, its highest level since 1983. The combination of historically high inflation and the rapidly tightening labor market spurred a growing number of Federal Reserve Board officials to indicate policy may need to be tightened more quickly than anticipated at the December 2022 meeting. FOMC members began to talk up the probability that a rate hike could be warranted in March. Today’s economy is much stronger, the labor market is much tighter, and inflation is much higher than when the Federal Reserve Board last shrank its balance sheet, officials noted.

As expected, the Federal Reserve Board’s January Statement strongly signaled that a March 2022 rate increase was a near certainty. Chair Powell acknowledged that no final decisions on the pace of tightening had been made. However, he read a scripted response several times to emphasize that those differences between today’s economy and the economy during the last cycle, when the Federal Reserve Board raised rates at every other meeting, “are likely to have important implications for the appropriate pace of policy adjustments.” Yields soared and the curve flattened. Fed funds futures priced in four hikes in 2022 with a chance of a fifth.

The employment situation improved nationally as well as in New York, Pennsylvania and in all of the thirteen counties representing our market areas in Pennsylvania and New York from one year ago when comparing December 31, 2021 to December 31, 2020. Nonfarm payrolls increased 467,000 in January 2022, well above expectations of 125,000 jobs. Projections for our local market unemployment are not readily available; however the most current economic statistics as of December 31, 2021 show continuing jobless claims of over 1.6 million. This remains elevated as does the unemployment rate at 5.4% per the latest report from the Bureau of Labor Statistics at December 31, 2021.

National, Pennsylvania, New York and our market area's non-seasonally-adjusted annual unemployment rates in 2021 and 2020, are summarized as follows:

	<u>2021</u>	<u>2020</u>
United States	5.4 %	8.1 %
New York (statewide)	7.2	10.1
Pennsylvania (statewide)	6.1	9.1
Broome County	5.5	8.7
Allegheny County	5.9	9.0
Bucks County	5.1	8.3
Lackawanna County	6.6	9.6
Lebanon County	5.3	8.0
Lehigh County	6.6	9.6
Luzerne County	7.9	10.9
Monroe County	7.5	11.6
Montgomery County	4.8	7.7
Northampton County	5.8	9.0
Schuylkill County	6.5	9.2
Susquehanna County	5.2	7.4
Wayne County	6.3	9.2
Wyoming County	6.1 %	8.4 %

#### **Review of Financial Position:**

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company ("Peoples Bank"), collectively, the "Company" or "Peoples." The Company services its retail and commercial customers through twenty-eight full-service community banking offices located within the Allegheny, Bucks, Lackawanna, Lebanon, Lehigh, Luzerne, Monroe, Montgomery, Northampton, Susquehanna and Wyoming Counties of Pennsylvania, Middlesex County of New Jersey and Broome County of New York.

Peoples Bank is a state-chartered bank and trust company under the jurisdiction of the Pennsylvania Department of Banking and Securities and the FDIC. Peoples Bank's primary product is loans to small- and medium-sized businesses. Other lending products include one-to-four family residential mortgages and consumer loans. Peoples Bank primarily funds its loans by offering checking accounts and money market accounts to commercial enterprises and individuals. Other deposit product offerings include certificates of deposits and various non-maturity deposit accounts.

The Company faces competition primarily from commercial banks, thrift institutions and credit unions within its Pennsylvania, New Jersey and New York market, many of which are substantially larger in terms of assets and capital. In addition, mutual funds and security brokers compete for various types of deposits, and consumer, mortgage, leasing and insurance companies compete for various types of loans and leases. Principal methods of competing for banking and permitted nonbanking services include price, nature of product, quality of service and convenience of location.

The Company and Peoples Bank are subject to regulations of certain federal and state regulatory agencies, including the Federal Reserve Board, the FDIC, and Pennsylvania Department of Banking and Securities, and undergo periodic examinations by such agencies.

Total assets, loans and deposits were \$3.4 billion, \$2.3 billion and \$3.0 billion, respectively, at December 31, 2021. Total assets, loans and deposits grew 16.9 percent, 6.9 percent and 21.6 percent, respectively, compared to 2020 year-end balances.

The loan portfolio consisted of \$1.9 billion of business loans, including commercial and commercial real estate loans, and \$372.5 million in retail loans, including residential mortgage and consumer loans at December 31, 2021. Total investment securities were \$588.7 million at December 31, 2021, including \$517.3 million of investment securities classified as available-for sale and \$71.2 million classified as held-to-maturity. Total deposits consisted of \$737.8 million in noninterest-bearing deposits and \$2.2 billion in interest-bearing deposits at December 31, 2021.

Stockholders' equity equaled \$340.1 million, or \$47.44 per share, at December 31, 2021, and \$316.9 million, or \$43.92 per share, at December 31, 2020. Our equity to asset ratio was 10.1 percent and 11.0 percent at those respective period ends. Dividends declared for the 2021 amounted to \$1.50 per share representing 24.9 percent of net income.

Nonperforming assets equaled \$5.0 million or 0.15 percent of total assets at December 31, 2021 compared to \$10.5 million or 0.36 percent at December 31, 2020. The allowance for loan losses equaled \$28.4 million or 1.22 percent of loans, net, at December 31, 2021, compared to \$27.3 million or 1.26 percent at year-end 2020. Loans charged-off, net of recoveries equaled \$0.7 million or 0.03 percent of average loans in 2021, compared to \$2.7 million or 0.13 percent of average loans in 2020.

### **Investment Portfolio:**

Primarily, our investment portfolio provides a source of liquidity needed to meet expected loan demand and generates a reasonable return in order to increase our profitability. Additionally, we utilize the investment portfolio to meet pledging requirements and reduce income taxes. At December 31, 2021, our portfolio consisted of short-term U.S. Treasury and government agency securities, which provide a source of liquidity, mortgage-backed securities issued by U.S. government-sponsored agencies to provide income and intermediate-term, tax-exempt state and municipal obligations, which mitigate our tax burden.

Our investment portfolio is subject to various risk elements that may negatively impact our liquidity and profitability. The greatest risk element affecting our portfolio is market risk or interest rate risk ("IRR"). Understanding IRR, along with other inherent risks and their potential effects, is essential in effectively managing the investment portfolio.

Market risk or IRR relates to the inverse relationship between bond prices and market yields. It is defined as the risk that increases in general market interest rates will result in market value depreciation. A marked reduction in the value of the investment portfolio could subject us to liquidity strains and reduced earnings if we are unable or unwilling to sell these investments at a loss. Moreover, the inability to liquidate these assets could require us to seek alternative funding, which may further reduce profitability and expose us to greater risk in the future. In addition, since the majority of our investment portfolio is designated as available-for-sale and carried at estimated fair value, with net unrealized gains and losses reported as a separate component of stockholders' equity, market value depreciation could negatively impact our capital position.

The FOMC decided to keep the target range for the federal funds rate at 0.00 to 0.25 percent throughout 2021 to continue to support the U.S. economy and the flow of credit to U.S. households and businesses. However, market rates have increased due to inflation concerns and the FOMC's recent statement to end asset purchases and increase the federal funds rate to address inflation. Our investment portfolio consists primarily of fixed-rate bonds. As a result, changes in the velocity and magnitude of future FOMC actions can significantly influence the fair value of our portfolio. Specifically, the parts of the yield curve most closely related to our investments include the 2-year and 10-year U.S. Treasury security. The yield on the 2-year U.S. Treasury note affects the values of our U.S. Treasury and government agency securities, whereas the 10-year U.S. Treasury note influences the value of tax-exempt and taxable state and municipal obligations. The yield on the 2-year U.S. Treasury increased 61 basis points in 2021, ending at 73 basis points. The yield on the 10-year U.S. Treasury increased 60 basis points in 2021, ending at 151 basis points. Since bond prices move inversely to yields, we experienced a decrease in the aggregate fair value of our investment portfolio when comparing December 31,

2021 to December 31, 2020 due to higher market rates at year end 2021. The net unrealized holding losses included in our available-for-sale investment portfolio were \$1.8 million at December 31, 2021 compared to a gain of \$9.7 million at December 31, 2020. We reported net unrealized holding loss, included as a separate component of stockholders' equity of \$1.4 million, net of income taxes of \$0.4 million, at December 31, 2021, and an unrealized holding gain of \$7.7 million, net of income taxes of \$2.0 million, at December 31, 2020. Further increases in interest rates could negatively impact the market value of our investments and our capital position. In order to monitor the potential effects a rise in interest rates could have on the value of our investments, we perform stress test modeling on the portfolio. Stress tests conducted on our portfolio at December 31, 2021, indicated that should general market rates increase immediately by 100, 200 or 300 basis points, we would anticipate declines of 4.7 percent, 9.3 percent and 13.9 percent in the market value of our available-for-sale portfolio.

Investment securities increased \$285.4 million, to \$588.7 million at December 31, 2021, from \$303.3 million at December 31, 2020. At December 31, 2021, the investment portfolio consisted of \$517.3 million of investment securities classified as available-for-sale and \$71.2 million classified as held-to-maturity. Deposit increases from strong organic growth from new and existing relationships, inflows of municipal deposits and proceeds from government stimulus payments lead to higher levels of low-yielding overnight federal funds balances. As the level of low-yielding overnight funds increased, our Asset Liability Committee recommended a strategy to deploy a portion of those funds into higher-yielding investments through purchases of U.S. Treasury securities, taxable and tax-free municipal bonds and mortgage-backed securities to mitigate risk in a flat and down rate environment. Security purchases totaled \$358.6 million in 2021. Investment purchases in 2020 amounted to \$107.2 million.

Repayments of investment securities totaled \$60.4 million in 2021 and \$85.0 million in 2020. No securities were sold in 2021. During the first quarter of 2020, the Company sold \$26.5 million of low-yielding short-term municipal bonds resulting in a gain of \$267 thousand. The proceeds were used to fund higher yielding loans. Additionally, two mortgage-backed securities were sold during the second half of 2020 with proceeds totaling \$38.3 million and gains recognized of \$651 thousand due to favorable market rates. We continually analyze the investment portfolio with respect to its exposure to various risk elements.

The composition of our investment portfolio changed during 2021 as a result of the aforementioned transactions. Short-term bullet U.S. Treasury and U.S. government-sponsored enterprise securities comprised 38.3 percent of our total portfolio at yearend 2021 compared to 27.7 percent at the end of 2020. Tax-exempt municipal obligations decreased as a percentage of the total portfolio to 18.6 percent at year-end 2021 from 21.1 percent at the end of 2020, however the total balance increased due to the new purchases. Taxable municipals decreased as a percentage of the total portfolio to 11.7 percent at year-end 2021 from 18.3 percent at the end of 2020, however, balances grew, as the sector provided income opportunities. The average life of the investment portfolio lengthened to 5.3 years at December 31, 2021 from 4.3 years at year end 2020, while the effective duration of the investment portfolio increased to 4.6 years at December 31, 2021 from 4.0 years at December 31, 2020.

There were no other-than-temporary impairments ("OTTI") recognized for the years ended December 31, 2021, 2020 and 2019. For additional information related to OTTI refer to Note 3 entitled "Investment securities" in the Notes to Consolidated Financial Statements to this Annual Report.

Investment securities averaged \$398.5 million and equaled 13.9 percent of average earning assets in 2021, compared to \$292.7 million and 11.7 percent of average earning assets in 2020. The tax-equivalent yield on the investment portfolio decreased 42 basis points to 1.94 percent in 2021 from 2.36 percent in 2020. The decrease in the tax-equivalent yield is due to cash flow from maturing and called bonds being reinvested into lower market rates coupled with lower yields on new purchases.

At December 31, 2021 and 2020, there were no securities of any individual issuer, except for U.S. government agency mortgage-backed securities, that exceeded 10.0 percent of stockholders' equity.

The maturity distribution based on the carrying value and weighted-average, tax-equivalent yield of the investment debt security portfolio at December 31, 2021, is summarized as follows. The weighted-average yield, based on amortized



cost, has been computed for tax-exempt state and municipals on a tax-equivalent basis using the prevailing federal statutory tax rate of 21.0 percent. The distributions are based on contractual maturity. Expected maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

**Maturity distribution of investment debt securities** (Dollars in thousands)

December 31, 2021	Within one year		After one but within five years		After five but within ten years		After ten years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasury securities	\$ 11,600	2.09 %	\$ 125,293	0.74 %	54,681	1.08			\$ 191,574	0.92 %
U.S. government-sponsored enterprises	16,150	1.80	14,588	1.68	\$ 28	4.48 %	\$ 3,013	2.24 %	33,779	1.79
State and municipals:										
Taxable	971	4.53	5,448	3.39	30,434	2.12	32,125	1.98	68,978	2.18
Tax-exempt	165	5.67	2,883	3.64	22,310	1.83	84,368	2.40	109,726	2.32
Corporate debt securities					2,918	4.08			2,918	4.08
Residential mortgage-backed securities:										
U.S. government agencies			295	1.82			20,349	1.40	20,644	1.40
U.S. government-sponsored enterprises			1,036	2.23	5,999	2.96	140,932	1.66	147,967	1.72
Commercial mortgage-backed securities:										
U.S. government-sponsored enterprises			10,501	2.35	2,447	3.07			12,948	2.49
Total	<u>\$ 28,886</u>	2.03 %	<u>\$ 160,044</u>	1.08 %	<u>\$ 118,817</u>	1.69 %	<u>\$ 280,787</u>	1.90 %	<u>\$ 588,534</u>	1.64 %

**Loan Portfolio:**

Economic factors and how they affect loan demand are of extreme importance to us and the overall banking industry, as lending is a primary business activity. Loans are the most significant component of earning assets and they generate the greatest amount of revenue for us. Similar to the investment portfolio, there are risks inherent in the loan portfolio that must be understood and considered in managing the lending function. These risks include IRR, credit concentrations and fluctuations in demand. Changes in economic conditions and interest rates affect these risks which influence loan demand, the composition of the loan portfolio and profitability of the lending function.

From a lending perspective, organic loan growth, excluding PPP loans, improved during 2021 resulting from our entrance into the Greater Pittsburgh market and Central New Jersey market with experienced market lenders, coupled with increased loan demand across all our legacy markets. We participated in the CARES Act, Paycheck Protection Program (“PPP”), a \$350 billion specialized low-interest loan program funded by the U.S. Treasury Department and administered by the U.S. Small Business Administration (“SBA”). The PPP provides borrower guarantees for lenders, as well as loan forgiveness incentives for borrowers that utilize the loan proceeds to cover employee compensation related business operating costs. During 2020, we had approved 1,450 PPP loans totaling \$217.5 million. Substantially all of the loans were made to existing customers, funded under the two year PPP loan program. PPP loan forgiveness commenced during the fourth quarter of 2020 and at December 31, 2021, 28 loans totaling \$13.6 million remain outstanding and are expected to be forgiven during 2022. In addition, the Company participated in the 2021 second round of PPP lending and received approval by the SBA on 1,062 applications totaling \$121.6 million. At December 31, 2021, 409 loans totaling \$55.3 million remain outstanding and are expected to be forgiven in 2022.

Overall, total loans increased \$151.2 million or 6.9 percent in 2021 to \$2.3 billion at December 31, 2021. Excluding PPP loans, loan growth totaled \$272.0 million or 13.7%. Business loans, including commercial loans and commercial real estate loans, were \$2.0 billion or 84.0 percent of total loans at December 31, 2021, and \$1.8 billion or 83.4 percent at year-end 2020. Residential mortgages and consumer loans totaled \$372.5 million or 16.0 percent of total loans at year-end 2021 and \$360.7 million or 16.6 percent at year-end 2020. Total loan growth, excluding PPP loans, of \$272.0 million was primarily attributable to increases in our commercial real estate portfolio which grew \$205.5 million in 2021

due to continued success of our strategy to expand in larger markets with strong growth potential, and strong organic growth in our legacy markets. Our expansion strategy commenced during 2014 in the Lehigh Valley with a community banking office and team of dedicated lenders and has expanded with two additional branch offices and additional teams of experienced lenders and credit professionals. Growth is also due to our presence in the Greater Delaware Valley, first by opening a branch office in King of Prussia in 2016, and during 2020 with the opening of a branch in Doylestown and recruitment of two experienced lenders. Further growth was attained by our entrance into Central Pennsylvania with a branch office in Lebanon, staffed with a team of lending professionals during the middle of 2018. Additionally, our continued expansion during the final six months of 2021 into the Greater Pittsburgh market with a new office and team of experienced lenders and entrance into Central New Jersey with an office in Piscataway, Middlesex County, and team of experienced lenders known in the market, contributed to the strong loan growth, especially during the later half of 2021. Based on the customer service oriented philosophy of our organization along with the commitment of these employees, we continue to be well received in these new markets as we are in our existing markets.

Residential mortgage loans increased \$20.2 million during 2021 as low market rates resulted in an increase of refinance and purchase activity. In addition, a higher percentage of mortgages were not eligible to be sold into the secondary market, including jumbo markets. Consumer loans declined \$8.4 million during 2021 primarily from the run-off in our indirect automobile portfolio due to pricing competition.

Loans averaged \$2.2 billion in 2021, compared to \$2.1 billion in 2020. Taxable loans averaged \$2.0 billion, while tax-exempt loans averaged \$0.2 billion in 2021. The loan portfolio continues to play the prominent role in our earning asset mix. As a percentage of earning assets, average loans equaled 77.2 percent in 2021, a decrease from 85.1 percent in 2020.

The tax-equivalent yield on our loan portfolio decreased 22 basis points to 3.94 percent in 2021 from 4.16 percent in 2020 due to lower yields on new loan originations, the repricing lower of floating and adjustable rate loans due to the decrease in market rates beginning during the second half of 2019 and continuing into 2020, and the low 1% interest rate on PPP loans. The PPP loans averaged \$147.0 million in 2021 and resulted in a 6 basis point increase to the overall loan yield compared to average PPP loans of \$148.3 million in 2020 and 13 basis point decline. The yield on the loan portfolio may continue to be under pressure as repayments on loans are replaced with new originations at current market rates, floating and adjustable rate loans continue to reprice lower and competition continues to prompt more aggressive pricing for high quality fixed rate intermediate term loans, thus providing downward momentum in loan yields.

The maturity distribution and sensitivity information of the loan portfolio by major classification at December 31, 2021, is summarized as follows:

**Maturity distribution and interest sensitivity of loan portfolio** (Dollars in thousands)

December 31, 2021	Within one year	After one but within five years	After five but within fifteen years	After fifteen years	Total
Maturity schedule:					
Commercial	\$ 169,035	\$ 241,541	\$ 189,055	\$ 13,496	\$ 613,127
Real estate:					
Commercial	273,269	679,993	386,378	3,899	1,343,539
Residential	76,595	159,782	61,210	37	297,624
Consumer	33,221	38,924	2,708	30	74,883
Total	\$ 552,120	\$ 1,120,240	\$ 639,351	\$ 17,462	\$ 2,329,173
Predetermined interest rates	\$ 308,120	\$ 592,784	\$ 263,173	\$ 8,832	\$ 1,172,909
Floating or adjustable interest rates	244,000	527,456	376,177	8,631	1,156,264
Total	\$ 552,120	\$ 1,120,240	\$ 639,350	\$ 17,463	\$ 2,329,173

As previously mentioned, there are numerous risks inherent in the loan portfolio. We manage the portfolio by employing sound credit policies and utilizing various modeling techniques in order to limit the effects of such risks. In addition, we

utilize private mortgage insurance (“PMI”) and guaranteed SBA and Federal Home Loan Bank of Pittsburgh (“FHLB-Pgh”) loan programs to mitigate credit risk in the loan portfolio.

In an attempt to limit IRR and liquidity strains, we continually examine the maturity distribution and interest rate sensitivity of the loan portfolio. Market interest rates began to increase during the final three months of 2021 and are expected to increase during 2022 as the FOMC has signaled it will begin to raise rates to fight inflation. However, given our IRR to flat or falling rates, we place emphasis on originating longer-term fixed-rate and adjustable-rate loans with interest rate floors. Fixed-rate loans represented 50.4 percent of the loan portfolio at December 31, 2021, compared to floating or adjustable-rate loans at 49.6 percent. Approximately 31.1 percent of the loan portfolio is expected to reprice within the next 12 months.

Additionally, our secondary market mortgage banking program provides us with an additional source of liquidity and a means to limit our exposure to IRR. Through this program, we are able to competitively price conforming one-to-four family residential mortgage loans without taking on IRR which would result from retaining these long-term, low fixed-rate loans on our books. The loans originated are subsequently sold in the secondary market, with the sales price locked in at the time of commitment, thereby greatly reducing our exposure to IRR.

Loan concentrations are considered to exist when the total amount of loans to any one borrower, or a multiple number of borrowers engaged in similar business activities or having similar characteristics, exceeds 25.0 percent of capital outstanding in any one category. We provide deposit and loan products and other financial services to individual and corporate customers in our current market area. There are no significant concentrations of credit risk from any individual counterparty or groups of counterparties, except for geographic concentrations in our market area.

Credit risk is the principal risk associated with these instruments. Our involvement and exposure to credit loss in the event that the instruments are fully drawn upon and the customer defaults is represented by the contractual amounts of these instruments. In order to control credit risk associated with entering into commitments and issuing letters of credit, we employ the same credit quality and collateral policies in making commitments that we use in other lending activities. We evaluate each customer’s creditworthiness on a case-by-case basis, and if deemed necessary, obtain collateral. The amount and nature of the collateral obtained is based on our credit evaluation.

#### **Asset Quality:**

We are committed to developing and maintaining sound, quality assets through our credit risk management policies and procedures. Credit risk is the risk to earnings or capital which arises from a borrower’s failure to meet the terms of their loan obligations. We manage credit risk by diversifying the loan portfolio and applying policies and procedures designed to foster sound lending practices. These policies include certain standards that assist lenders in making judgments regarding the character, capacity, cash flow, capital structure and collateral of the borrower.

With regard to managing our exposure to credit risk in light of general devaluations in real estate values, we have established maximum loan-to-value ratios for commercial mortgage loans not to exceed 80.0 percent of the appraised value. With regard to residential mortgages, customers with loan-to-value ratios in excess of 80.0 percent are generally required to obtain Private Mortgage Insurance (“PMI”). PMI is used to protect us from loss in the event loan-to-value ratios exceed 80.0 percent and the customer defaults on the loan. Appraisals are performed by an independent appraiser engaged by us, not the customer, who is either state certified or state licensed depending upon collateral type and loan amount.

With respect to lending procedures, lenders and our credit underwriters must determine the borrower’s ability to repay their loans based on prevailing and expected market conditions prior to requesting approval for the loan. The Bank’s board of directors establishes and reviews, at least annually, the lending authority for certain senior officers, loan underwriters and branch personnel. Credit approvals beyond the scope of these individual authority levels are forwarded to a loan committee. This committee, comprised of certain members of senior management, review credits to monitor the quality of the loan portfolio through careful analysis of credit applications, adherence to credit policies and the

examination of outstanding loans and delinquencies. These procedures assist in the early detection and timely follow-up of problem loans.

Credit risk is also managed by monthly internal reviews of individual credit relationships in our loan portfolio by credit administration and the asset quality committee. These reviews aid us in identifying deteriorating financial conditions of borrowers and allows us the opportunity to assist customers in remedying these situations.

Nonperforming assets consist of nonperforming loans and foreclosed assets. Nonperforming loans include nonaccrual loans, troubled debt restructured loans and accruing loans past due 90 days or more. For a discussion of our policy regarding nonperforming assets and the recognition of interest income on impaired loans, refer to the notes entitled, “Summary of significant accounting policies — Nonperforming assets,” and “Loans, net and allowance for loan losses” in the Notes to Consolidated Financial Statements to this Annual Report which are incorporated in this item by reference.

Information concerning nonperforming assets for the past two years is summarized as follows. The table includes credits classified for regulatory purposes and all material credits that cause us to have serious doubts as to the borrower’s ability to comply with present loan repayment terms.

**Distribution of nonperforming assets** (Dollars in thousands)

December 31	2021	2020
Nonaccrual loans	\$ 2,811	\$ 6,981
Troubled debt restructured loans (including nonaccrual TDR)	1,649	2,818
Accruing loans past due 90 days or more:	13	71
Total nonperforming loans	4,473	9,870
Foreclosed assets	488	632
Total nonperforming assets	\$ 4,961	\$ 10,502
Loans modified in a troubled debt restructuring (TDR):		
Performing TDR loans	\$ 1,649	\$ 1,682
Nonperforming TDR loans		1,136
Total TDR loans	\$ 1,649	\$ 2,818
Total loans held for investment	\$ 2,329,173	\$ 2,177,982
Nonaccrual loans as a percentage of loans held for investment	0.12 %	0.32 %
Allowance for loan losses	28,383	27,344
Allowance for loan losses as a percentage of loans held for investment	1.22 %	1.26 %
Allowance for loan losses as a percentage of nonaccrual loans	1009.71 %	391.69 %
Nonperforming loans as a percentage of loans, net	0.19 %	0.45 %

We experienced improved asset quality during 2021 as evidenced by a decrease in nonperforming assets of \$5.5 million or 52.8% when compared to yearend 2020. Additionally, our nonperforming assets as a percentage of total assets improved to 0.15 percent at December 31, 2021 from 0.36 percent at December 31, 2020, and our nonperforming loans as a percentage of loans, net improved to 0.19 percent from 0.45 percent at December 31, 2020. Improvement in each category from year-end 2020 was experienced. A reduction of \$4.2 million to nonaccrual loans was the primary reason for the improvement. Loans on nonaccrual status, excluding trouble debt restructured nonaccrual loans, decreased \$4.2 million and resulted in part from the \$1.5 million payoff of one commercial credit, a refinance of a \$1.0 million commercial relationship with the addition of a credit enhancement and guaranty, a charge-off of a \$0.4 million small business line of credit and the transfer of a \$0.5 million hospitality related commercial real estate loan to other real estate. Restructured loans decreased \$1.2 million when comparing December 31, 2021 and 2020, respectively, due to the payoff of two unrelated commercial loans and principal payments received. Foreclosed assets comprised three properties at December 31, 2021 and we expect the one hospitality related property to be sold during the first quarter of 2022. For a further discussion of assets classified as nonperforming assets and potential problem loans, refer to the note entitled, “Loans, net and the allowance for loan losses,” in the Notes to Consolidated Financial Statements to this Annual Report.

We maintain the allowance for loan losses at a level we believe adequate to absorb probable credit losses related to individually evaluated loans, as well as probable incurred losses inherent in the remainder of the loan portfolio as of the balance sheet date. The balance in the allowance for loan losses account is based on past events and current economic conditions. We employ the Federal Financial Institutions Examination Council (“FFIEC”) Interagency Policy Statement, as amended, and GAAP in assessing the adequacy of the allowance account. Under GAAP, the adequacy of the allowance account is determined based on the provisions of FASB Accounting Standards Codification (“ASC”) 310 for loans specifically identified to be individually evaluated for impairment and the requirements of FASB ASC 450, for large groups of smaller-balance homogeneous loans to be collectively evaluated for impairment.

We follow our systematic methodology in accordance with procedural discipline by applying it in the same manner regardless of whether the allowance is being determined at a high point or a low point in the economic cycle. Each quarter, our credit administration department identifies those loans to be individually evaluated for impairment and those to be collectively evaluated for impairment utilizing a standard criteria. We consistently use loss experience from the latest twelve quarters in determining the historical loss factor for each pool collectively evaluated for impairment. Qualitative factors are evaluated in the same manner each quarter and are adjusted within a relevant range of values based on current conditions to assure directional consistency of the allowance for loan loss account. Regulators, in reviewing the loan portfolio as part of the scope of a regulatory examination, may require us to increase our allowance for loan losses or take other actions that would require increases to our allowance for loan losses.

For a further discussion of our accounting policies for determining the amount of the allowance and a description of the systematic analysis and procedural discipline applied, refer to the note entitled, “Summary of significant accounting policies— Allowance for loan losses,” in the Notes to Consolidated Financial Statements to this Annual Report.

The following table presents average loans and loan loss experience for the periods indicated.

December 31	2021			
	Average loans	Net Charge-offs (Recoveries)	Net Charge-offs (Recoveries) to Average Loans	
Commercial	\$ 648,192	\$ 403	0.06	%
Real estate:				
Commercial	1,209,639	184	0.02	%
Residential	284,060	17	0.01	%
Consumer	78,686	107	0.14	%
Total	\$ 2,220,577	\$ 711	0.03	%

December 31	2020			
	Average loans	Net Charge-offs (Recoveries)	Net Charge-offs (Recoveries) to Average Loans	
Commercial	\$ 651,635	\$ 2,246	0.34	%
Real estate:				
Commercial	1,085,237	128	0.01	%
Residential	294,952	190	0.06	%
Consumer	91,252	169	0.02	%
Total	\$ 2,123,076	\$ 2,733	0.13	%

December 31	2019			
	Average loans	Net Charge-offs (Recoveries)	Net Charge-offs (Recoveries) to Average Loans	
Commercial	\$ 506,000	\$ 3,245	0.64	%
Real estate:				
Commercial	948,673	816	0.09	%
Residential	299,105	448	0.15	%
Consumer	111,779	293	0.26	%
Total	\$ 1,865,557	\$ 4,802	0.26	%

The allowance for loan losses increased \$1.1 million to \$28.4 million at December 31, 2021, from \$27.3 million at the end of 2020. The increase resulted from a provision for loan losses of \$1.8 million less net loans charged-off of \$0.7 million. The allowance for loan losses at December 31, 2021 continued to reflect the provisions added during 2020 from our adjustment of qualitative factors in our allowance for loan losses methodology, due to economic decline and expectation of increased credit losses from COVID-19's adverse impact on economic and business operating conditions.

The decrease to charge-offs in 2021 is due to improved credit quality. The 2021 period includes the total charge-off of a fully allocated small-business line of credit originated in our Greater Delaware Valley market totaling \$0.4 million. During 2020, \$0.9 million was charged-off related to small-business lines of credit originated in our Greater Delaware Valley market offset by \$0.2 million of recoveries.

The allowance for loan losses, as a percentage of loans, net of unearned income, was 1.22 percent at the end of 2021, 1.26 percent at the end of 2020, respectively. Excluding PPP loans that do not carry an allowance for losses due to a 100 percent government guarantee, the ratio equaled 1.26 percent at December 31, 2021.

Past due loans not satisfied through repossession, foreclosure or related actions are evaluated individually to determine if all or part of the outstanding balance should be charged against the allowance for loan losses account. Any subsequent recoveries are credited to the allowance account. Net loans charged-off decreased \$2.0 million to \$0.7 million in 2021 from \$2.7 million in 2020. Net charge-offs, as a percentage of average loans outstanding, equaled 0.03 percent in 2021 and 0.13 percent in 2020.

## Allocation of the allowance for loan losses (Dollars in thousands)

The allocation of the allowance for loan losses for the past two years is summarized as follows:

December 31	2021		2020	
	Amount	%	Amount	%
Specific:				
Commercial	\$ 40	0.01 %	\$ 947	0.20 %
Real Estate:				
Commercial	109	0.12	180	0.18
Residential	26	0.06	75	0.07
Consumer				
Total specific	175	0.19	1,202	0.45
Formula:				
Commercial	8,413	26.31	7,787	30.99
Real Estate:				
Commercial	15,819	57.56	14,379	52.07
Residential	3,183	12.72	3,054	12.67
Consumer	793	3.22	922	3.82
Total formula	28,208	99.81	26,142	99.55
Total allowance	\$ 28,383	100.00 %	\$ 27,344	100.00 %

The allowance for loan losses account increased \$1.1 million to \$28.4 million at December 31, 2021, compared to \$27.3 million at December 31, 2020. The specific portion of the allowance for impairment of loans individually evaluated under FASB ASC 310 decreased \$1.0 million to \$0.2 million at December 31, 2021, from \$1.2 million at December 31, 2020 and the formula portion of the allowance for loans collectively evaluated for impairment under FASB ASC 450, increased \$2.1 million to \$28.2 million at December 31, 2021, from \$26.1 million at December 31, 2020. The decrease in the specific portion of the allowance was a result of a decrease in measured impairment for collateral dependent loans, improved credit quality and a decrease to non-performing loans of \$5.4 million. The increase in the formula portion was primarily the result of a significant increase in volume, improved credit quality and a decrease of \$5.4 million of non-performing loans.

The coverage ratio, the allowance for loan losses, as a percentage of nonperforming loans, is an industry ratio used to test the ability of the allowance account to absorb potential losses arising from nonperforming loans. The coverage ratio was 634.5 percent at December 31, 2021 and 277.0 percent at December 31, 2020. We believe that our allowance was adequate to absorb probable credit losses at December 31, 2021.

## Deposits:

Our deposit base is the primary source of funds to support our operations. We offer a variety of deposit products to meet the needs of our individual and commercial customers. Total deposits grew \$526.3 million or 21.6 percent to \$3.0 billion at the end of 2021. The increase in deposits is due to organic growth of customer relationships throughout all our markets, inflows of municipal deposits and additional deposits by our commercial and retail customers in excess of historic levels, in part to government stimulus. Total deposits include \$12.5 million of brokered certificates of deposit. Noninterest-bearing deposits grew \$115.3 million or 18.5 percent while interest-bearing deposits increased \$411.0 million or 22.6 percent in 2021. Noninterest-bearing deposits represented 24.9 percent of total deposits while interest-bearing deposits accounted for 75.1 percent of total deposits at December 31, 2021. Comparatively, noninterest-bearing deposits and interest-bearing deposits represented 34.4 percent and 74.5 percent of total deposits at year end 2020. With regard to noninterest-bearing deposits, personal checking accounts increased \$54.5 million or 19.9 percent, while commercial checking accounts increased \$60.7 million or 17.4 percent. The increase in noninterest-bearing deposits is essential in attempting to keep our overall cost of funds low given the pressure on our net interest margin from the decrease in short-term market rates.



With regard to interest-bearing deposits, interest-bearing transaction accounts, which include money market accounts and NOW accounts, and savings accounts, increased \$436.2 million in 2021. Commercial interest-bearing transaction accounts increased \$302.8 million, while personal interest-bearing transaction accounts increased \$72.8 million. Savings accounts increased \$60.6 million during 2021 as customers saved a higher percentage of the government stimulus in safe liquid accounts. The strong growth in our non-maturity deposits was due to continuing our strategic initiative to grow our public fund deposits and continued organic growth in all our markets. Total time deposits decreased \$25.2 million to \$294.5 million at December 31, 2021 from \$319.7 million at December 31, 2020. The decrease was due to depositors shifting funds to more liquid accounts and the redemption of a few large municipal accounts.

The average amount of, and the rate paid on, the major classifications of deposits for the past three years are summarized as follows:

**Deposit distribution** (Dollars in thousands)

Year ended December 31	2021		2020		2019	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
<b>Interest-bearing:</b>						
Money market accounts	\$ 549,169	0.36 %	\$ 432,621	0.81 %	\$ 349,668	1.31 %
NOW accounts	666,885	0.33	470,701	0.58	394,494	0.75
Savings accounts	468,851	0.08	404,628	0.12	380,175	0.13
Time deposits	301,024	0.92	355,030	1.40	367,666	1.90
Total interest-bearing	1,985,929	0.37 %	1,662,980	0.71 %	1,492,003	1.01 %
<b>Noninterest-bearing</b>	<b>684,527</b>		<b>555,459</b>		<b>434,676</b>	
Total deposits	<u>\$ 2,670,456</u>		<u>\$ 2,218,439</u>		<u>\$ 1,926,679</u>	

Total deposits averaged \$2.7 billion in 2021 and \$2.2 billion in 2020, increasing \$452.0 million or 20.4 percent comparing 2021 to 2020. Average noninterest-bearing deposits increased \$129.1 million, while average interest-bearing accounts grew \$322.9 million. Average interest-bearing transaction deposits, including money market and NOW, and savings accounts, increased \$377.0 million while average total time deposits decreased \$53.7 million when comparing 2021 and 2020.

Our cost of interest-bearing deposits decreased 34 basis points to 0.37 percent in 2021 from 0.71 percent in 2020. Specifically, the cost of money market accounts decreased 45 basis points to 0.36 percent from 0.81 percent, NOW accounts decreased 25 basis points and the cost of time deposits decreased 48 basis points to 0.92 percent comparing 2021 and 2020. The decreases to the cost of our interest-bearing deposits was the result of our initiative to reduce premium rates being paid on core deposit relationships and the reduction of stated rates across all deposit products. The reductions are directly related to the FOMC's decision to decrease the target federal funds rate 225 basis points commencing in 2019 and ending in the first three months of 2020, first in response to economic slowdown and then due to the COVID-19 crisis. We expect our cost of funds to continue to decline as time deposits mature and reinvest into lower rates, however, expected actions by the FOMC to increase the federal funds rate may result in us increasing deposit rates.

Volatile deposits, time deposits \$100 or more, averaged \$172.7 million in 2021, a decrease of \$27.6 million or 13.8 percent from \$200.3 million in 2020. Our average cost of these funds decreased 68 basis points to 0.78 percent in 2021, from 1.46 percent in 2020. This type of funding is susceptible to withdrawal by the depositor as they are particularly price sensitive and are therefore not considered to be a strong source of liquidity.

At December 31, 2021 and 2020, the Corporation had \$1.2 billion and \$884.6 million, respectively, in uninsured deposits in excess of the FDIC insurance limit of \$250,000. At December 31, 2021 and 2020, the Corporation had \$88.3 million and \$95.8 million, respectively, in time deposits in excess of \$250,000 maturing disclosed in the table below. Brokered deposits in the amount of \$12.5 million at December 31, 2021 and \$25.0 million at December 31, 2020 are not included in time deposits more than \$250,000.



<b>December 31</b>	<b>2021</b>	<b>2020</b>
Within three months	\$ 29,579	\$ 21,783
After three months but within six months	25,453	31,010
After six months but within twelve months	19,462	29,258
After twelve months	13,801	13,701
Total	<u>\$ 88,295</u>	<u>\$ 95,752</u>

In addition to deposit gathering, we have a secondary source of liquidity through existing credit arrangements with the FHLB-Pgh. As deposit balances grew during 2021 due to government stimulus and increases in commercial and municipal accounts, short-term borrowings with the FHLB were paid down. At year end 2021, we maintained a high on-balance sheet liquidity position and expect limited utilization of the credit facility during 2022. For a further discussion of our borrowings and their terms, refer to the notes entitled, “Short-term borrowings” and “Long-term debt,” in the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

### **Subordinated Debt:**

On June 1, 2020, the Company sold \$33,000 aggregate principal amount of Subordinated Notes due 2030 (the “2020 Notes”) to accredited investors. The 2020 Notes are treated as Tier 2 capital for regulatory capital purposes.

The 2020 Notes bear interest at a rate of 5.375% per year for the first five years and then float based on a benchmark rate (as defined), provided that the interest rate applicable to the outstanding principal balance during the period the 2020 Notes are floating will at no time be less than 4.75%. Interest is payable semi-annually in arrears on June 1 and December 1 of each year for the first five years after issuance and will be payable quarterly in arrears thereafter on March 1, June 1, September 1, and December 1. The 2020 Notes mature on June 1, 2030 and are redeemable in whole or in part, without premium or penalty, at any time on or after June 1, 2025 and prior to June 1, 2030. Additionally, if all or any portion of the 2020 Notes cease to be deemed Tier 2 Capital, the Company may redeem, in whole and not in part, at any time upon giving not less than ten days’ notice, an amount equal to one hundred percent (100%) of the principal amount outstanding plus accrued but unpaid interest to but excluding the date fixed for redemption.

Holders of the 2020 Notes may not accelerate the maturity of the 2020 Notes, except upon the bankruptcy, insolvency, liquidation, receivership or similar proceeding by or against the Company.

### **Market Risk Sensitivity:**

Market risk is the risk to our earnings and/or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. Our exposure to market risk is primarily IRR associated with our lending, investing and deposit gathering activities. During the normal course of business, we are not exposed to foreign exchange risk or commodity price risk. Our exposure to IRR can be explained as the potential for change in our reported earnings and/or the market value of our net worth. Variations in interest rates affect the underlying economic value of our assets, liabilities and off-balance sheet items. These changes arise because the present value of future cash flows, and often the cash flows themselves, change with interest rates. The effects of the changes in these present values reflect the change in our underlying economic value, and provide a basis for the expected change in future earnings related to interest rates. Interest rate changes affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. IRR is inherent in the role of banks as financial intermediaries. However, a bank with a high degree of IRR may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities.

The FOMC kept the federal funds rate at the targeted range of 0.00 to 0.25 percent throughout all of 2021 due to uncertainty of the pandemic and its effect on the economy. The timing and the magnitude of future monetary policy actions that will impact the current interest rate environment are uncertain, however, the FOMC is expected to begin to increase the federal funds rate in 2022 to combat inflation. Given these conditions, IRR and the ability to effectively

manage it, are extremely critical to both bank management and regulators. The FFIEC through its advisory guidance reiterates the importance of effective corporate governance, policies and procedures, risk measuring and monitoring systems, stress testing and internal controls related to the IRR exposure of depository institutions. According to the advisory, the bank regulators believe that the current financial market and economic conditions present significant risk management challenges to all financial institutions. Although the bank regulators recognize that some degree of IRR is inherent in banking, they expect institutions to have sound risk management practices in place to measure, monitor and control IRR exposure. The advisory states that the adequacy and effectiveness of an institution's IRR management process and the level of IRR exposure are critical factors in the bank regulators' evaluation of an institution's sensitivity to changes in interest rates and capital adequacy. Material weaknesses in risk management processes or high levels of IRR exposure relative to capital will require corrective action. We believe our risk management practices with regard to IRR were suitable and adequate given the level of IRR exposure at December 31, 2021.

The Asset/Liability Committee ("ALCO"), comprised of members of our bank's board of directors, senior management and other appropriate officers, oversees our IRR management program. Specifically, ALCO analyzes economic data and market interest rate trends, as well as competitive pressures, and utilizes several computerized modeling techniques to reveal potential exposure to IRR. This allows us to monitor and attempt to control the influence these factors may have on our rate sensitive assets ("RSA"), rate sensitive liabilities ("RSL") and overall operating results and financial position.

With respect to evaluating our exposure to IRR on earnings, we utilize a gap analysis model that considers repricing frequencies of RSA and RSL. Gap analysis attempts to measure our interest rate exposure by calculating the net amount of RSA and RSL that reprice within specific time intervals. A positive gap occurs when the amount of RSA repricing in a specific period is greater than the amount of RSL repricing within that same time frame and is indicated by a RSA/RSL ratio greater than 1.0. A negative gap occurs when the amount of RSL repricing is greater than the amount of RSA and is indicated by a RSA/RSL ratio less than 1.0. A positive gap implies that earnings will be impacted favorably if interest rates rise and adversely if interest rates fall during the period. A negative gap tends to indicate that earnings will be affected inversely to interest rate changes.

Our interest rate sensitivity gap position, illustrating RSA and RSL at their related carrying values, is summarized as follows. The distributions in the table are based on a combination of maturities, call provisions, repricing frequencies and prepayment patterns. Adjustable-rate assets and liabilities are distributed based on the repricing frequency of the instrument. Mortgage instruments are distributed in accordance with estimated cash flows, assuming there is no change in the current interest rate environment.

**Interest rate sensitivity** (Dollars in thousands)

December 31, 2021	Due within three months	Due after three months but within twelve months	Due after one year but within five years	Due after five years	Total
Rate-sensitive assets:					
Interest-bearing deposits in other banks	\$ 7,093				\$ 7,093
Federal funds sold	242,425				242,425
Investment securities	17,023	\$ 37,137	\$ 267,858	\$ 266,656	588,674
Total loans	676,204	349,643	963,675	339,650	2,329,172
Loans held for sale	408				408
Total rate-sensitive assets	<u>\$ 943,153</u>	<u>\$ 386,780</u>	<u>\$ 1,231,533</u>	<u>\$ 606,306</u>	<u>\$ 3,167,772</u>
Rate-sensitive liabilities:					
Money market accounts	\$ 588,245				\$ 588,245
NOW accounts	361,059		\$ 490,027		851,086
Savings accounts			491,796		491,796
Time deposits less than \$100 thousand	12,786	\$ 29,824	51,672	\$ 7,596	101,878
Time deposits \$100 thousand or more	49,489	104,008	35,250	3,889	192,636
Short-term borrowings					
Long-term debt	569	1,746	396		2,711
Subordinated debt			33,000		33,000
Total rate-sensitive liabilities	<u>\$ 1,012,148</u>	<u>\$ 135,578</u>	<u>\$ 1,102,141</u>	<u>\$ 11,485</u>	<u>\$ 2,261,352</u>
Rate-sensitivity gap:					
Period	\$ (68,995)	\$ 251,202	\$ 129,392	\$ 594,821	
Cumulative	\$ (68,995)	\$ 182,207	\$ 311,599	\$ 906,420	
RSA/RSL ratio:					
Period	0.93	2.85	1.12	52.79	
Cumulative	0.93	1.16	1.14	1.40	1.40

At December 31, 2021, we had cumulative one-year RSA/RSL ratio of 1.16, a positive gap. At December 31, 2020, we had cumulative one-year RSA/RSL of 1.39, a positive gap. As previously mentioned, a positive gap indicates that if interest rates increase, our earnings would likely be favorably impacted. Given the current economic conditions and the expected action of the FOMC to begin to increase the federal funds rate during the first quarter of 2022, we should experience increased net interest income. The overall focus of ALCO is to maintain a well-balanced IRR position in order to safeguard future earnings during historical low-rate environment and from potential risk to falling interest rates. During 2021 ALCO took steps to reduce our positive gap position and guard against rates unchanged or down through the origination of fixed rate loans and the investment in longer term, fixed rate investment securities. Additionally, an initiative to reduce funding costs was executed to mitigate the adverse impact to net interest income from the low rates. ALCO will continue to focus efforts on strategies in 2022 in an attempt to maintain a positive gap position between RSA and RSL. However, these forward-looking statements are qualified in the aforementioned section entitled “Forward-Looking Discussion” in this Management’s Discussion and Analysis.

The change in our cumulative one-year ratio from the previous year-end resulted from a \$25.7 million or 1.9 percent decrease in RSA offset by a \$170.5 million or 17.5 percent increase in RSL maturing or repricing within one year. The decrease in RSA resulted primarily from a \$64.0 million decrease in total loans, net of unearned income, resulting from an increase in commercial lending, which involves loans with longer-term adjustable rates.

With respect to the \$170.5 million increase in RSL maturing or repricing within a twelve month time horizon, non-maturity deposits increased \$250.8 million due to customers seeking liquid accounts and saving at a higher percentage due to the economic uncertainty of the pandemic. The growth in deposits resulted in lower short-term borrowings of \$50.0 million. Time deposits also declined when comparing year end 2021 to 2020 as a number of large accounts matured and customers sought more liquid alternatives.

Static gap analysis, although a credible measuring tool, does not fully illustrate the impact of interest rate changes on future earnings. First, market rate changes normally do not equally or simultaneously affect all categories of assets and liabilities. Second, assets and liabilities that can contractually reprice within the same period may not do so at the same time or to the same magnitude. Third, the interest rate sensitivity table presents a one-day position and variations occur daily as we adjust our rate sensitivity throughout the year. Finally, assumptions must be made in constructing such a table. For example, the conservative nature of our Asset/Liability Management Policy assigns personal NOW accounts to the “Due after three months but within twelve months” repricing interval. In reality, these accounts may reprice less frequently and in different magnitudes than changes in general market interest rate levels.

We utilize a simulation model to address the failure of the static gap model to address the dynamic changes in the balance sheet composition or prevailing interest rates and to enhance our asset/liability management. This model creates pro forma net interest income scenarios under various interest rate shocks. Given instantaneous and parallel shifts in general market rates of plus 100 basis points, our projected net interest income for the 12 months ending December 31, 2022, would increase at 2.0 percent from model results using current interest rates.

We will continue to monitor our IRR position in 2022 and anticipate employing deposit and loan pricing strategies and directing the reinvestment of loan and investment payments and prepayments in order to maintain our target IRR position.

Financial institutions are affected differently by inflation than commercial and industrial companies that have significant investments in fixed assets and inventories. Most of our assets are monetary in nature and change correspondingly with variations in the inflation rate. It is difficult to precisely measure the impact inflation has on us, however, we believe that our exposure to inflation can be mitigated through our asset/liability management program.

#### **Liquidity:**

Liquidity management is essential to our continuing operations as it gives us the ability to meet our financial obligations as they come due, as well as to take advantage of new business opportunities as they arise. Our financial obligations include, but are not limited to, the following:

- Funding new and existing loan commitments;
- Payment of deposits on demand or at their contractual maturity;
- Repayment of borrowings as they mature;
- Payment of lease obligations; and
- Payment of operating expenses.

Our liquidity position is impacted by several factors which include, among others, loan origination volumes, loan and investment maturity structure and cash flows, demand for core deposits and certificate of deposit maturity structure and retention. We manage these liquidity risks daily, thus enabling us to monitor fluctuations in our position and to adapt our position according to market influence and balance sheet trends. We also forecast future liquidity needs and develop strategies to ensure adequate liquidity at all times.

Historically, core deposits have been our primary source of liquidity because of their stability and lower cost, in general, than other types of funding. Providing additional sources of funds are loan and investment payments and prepayments and the ability to sell both available-for-sale securities and mortgage loans held for sale. As a final source of liquidity, we have available borrowing arrangements with various financial intermediaries, including the FHLB-Pgh. At December 31, 2021, our maximum borrowing capacity with the FHLB-Pgh was \$896.1 million of which \$2.7 million was outstanding in borrowings and \$373.0 million outstanding in the form of irrevocable standby letters of credit. We believe our liquidity is adequate to meet both present and future financial obligations and commitments on a timely basis.

We maintain a contingency funding plan to address liquidity in the event of a funding crisis. Examples of some of the causes of a liquidity crisis include, among others, natural disasters, pandemics, war, events causing reputational harm and severe and prolonged asset quality problems. The plan recognizes the need to provide alternative funding sources in times of crisis that go beyond our core deposit base. As a result, we have created a funding program that ensures the availability of various alternative wholesale funding sources that can be used whenever appropriate. Identified alternative funding sources include:

- FHLB-Pgh liquidity contingency line of credit;
- Federal Reserve discount window;
- Internet certificates of deposit;
- Brokered deposits;
- Institutional Deposit Corporation deposits;
- Repurchase agreements; and
- Federal funds purchased.

We have increased our borrowing capacity at the Federal Reserve by establishing a borrower-in-custody of collateral arrangement that enables us to pledge certain loans, not being used as collateral at the FHLB-Pgh, as collateral for borrowings at the Federal Reserve. At December 31, 2021 our borrowing capacity at the Federal Reserve related to this program was \$147.9 million and there were no amounts outstanding.

Based on our liquidity position at December 31, 2021, we do not anticipate the need to utilize any of these sources in the near term.

We employ a number of analytical techniques in assessing the adequacy of our liquidity position. One such technique is the use of ratio analysis to illustrate our reliance on noncore funds to fund our investments and loans maturing after 2021. At December 31, 2021, our noncore funds consisted of time deposits in denominations of \$100 thousand or more, short-term borrowings, and long-term and subordinated debt. Large denomination time deposits are particularly not considered to be a strong source of liquidity since they are very interest rate sensitive and are considered to be highly volatile. At December 31, 2021, our net noncore funding dependence ratio, the difference between noncore funds and short-term investments to long-term assets, was negative 3.0 percent. Our net short-term noncore funding dependence ratio, noncore funds maturing within one year, less short-term investments to long-term assets equaled negative 5.6 percent due to our short-term investments being greater than the non-core funding. Comparatively, our ratios equaled 2.8 percent and negative 1.3 percent at the end of 2020, which indicates a significant decrease in our reliance on noncore funds in 2021. Moreover, our basic liquidity surplus ratio, defined as liquid assets less short-term potentially volatile liabilities as a percentage of total assets, increased to 14.6 percent at December 31, 2021, from 8.7 percent at December 31, 2020. We believe that by supplying adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, we can ensure adequate liquidity to support future growth.

The Consolidated Statements of Cash Flows present the change in cash and cash equivalents from operating, investing and financing activities. Cash and cash equivalents consist of cash on hand, cash items in the process of collection, noninterest-bearing and interest-bearing deposits with other banks and federal funds sold. Cash and cash equivalents increased \$51.7 million for the year ended December 31, 2021. For the year ended December 31, 2020, cash and cash equivalents increased \$197.0 million. During 2021, cash provided by operating and financing activities more than offset cash used in investing activities.

Operating activities provided net cash of \$40.8 million in 2021 and \$37.2 million in 2020. Net income, adjusted for the effects of noncash expenses such as depreciation, amortization and accretion of tangible and intangible assets and investment securities, and the provision for loan losses, is the primary source of funds from operations.

Net cash provided by financing activities equaled \$451.1 million in 2021. Net cash provided by financing activities was \$361.1 million in 2020. Deposit gathering, which is our predominant financing activity, increased in both 2021 and 2020. Deposit gathering provided a net cash inflow in 2021 of \$526.3 million and \$465.6 million in 2020. Short-term borrowings decreased net cash by \$50.0 million in 2021 and by \$102.2 million in 2020. Deposit gathering in 2021 was also partially offset by a \$12.1 million net decrease in long-term debt as well as cash dividends paid of \$10.8 million. In 2020, deposit gathering and the issuance of \$33.0 million of subordinated debt was partially offset by a net \$18.0 million repayment of long-term debt and cash dividends paid of \$10.5 million.

Our primary investing activities involve transactions related to our investment and loan portfolios. Net cash used in investing activities totaled \$440.1 million and \$201.2 million in 2021 and 2020, respectively. Net cash used in lending activities was \$152.0 million in 2021, a decrease from \$241.3 million in 2020. Activities related to our investment portfolio used net cash of \$298.2 million in 2020 and provided net cash of \$43.0 million in 2020.

We anticipate maintaining a relatively stable liquidity position in 2022. Our continued growth in the expanding Lehigh Valley and King of Prussia markets coupled with our maturing Lebanon County office and new offices in the Greater Pittsburgh market and Central New Jersey is expected to produce strong loan demand throughout 2022. We expect to fund such demand through deposit gathering initiatives, payments and prepayments on loans and investments and advances from the FHLB. However, we cannot predict the economic climate or the savings habits of consumers. Should economic conditions improve, deposit gathering may be negatively impacted as depositors seek alternative investments or increase spending. Regardless of economic conditions and stock market fluctuations, we believe that through constant monitoring and adherence to our liquidity plan, we will have the means to provide adequate cash to fund our normal operations in 2022.

#### **Cash Requirements:**

The Company has cash requirements for various financial obligations, including contractual obligations and commitments that require cash payments. The most significant contractual obligation, in both the under and over one-year time period, is for the Bank to repay time deposits. The Company anticipates meeting these obligations by utilizing on-balance sheet liquidity and continuing to provide convenient depository and cash management services through its branch network, thereby replacing these contractual obligations with similar fund sources at rates that are competitive in our market. The Company may also use borrowings and brokered deposits to meet its obligations.

Commitments to extend credit are the Company's most significant commitment in both the under and over one-year time periods. These commitments do not necessarily represent future cash requirements in that these commitments often expire without being drawn upon.

#### **Capital Adequacy:**

We believe a strong capital position is essential to our continued growth and profitability. We strive to maintain a relatively high level of capital to provide our depositors and stockholders with a margin of safety. In addition, a strong capital base allows us to take advantage of profitable opportunities, support future growth and provide protection against any unforeseen losses.

Our ALCO reviews our capital position, generally, quarterly. As part of its review, the ALCO considers: (i) the current and expected capital requirements, including the maintenance of capital ratios in excess of minimum regulatory guidelines; (ii) potential changes in the market value of our securities due to interest rates changes and effect on capital; (iii) projected organic and inorganic asset growth; (iv) the anticipated level of net earnings and capital position, taking into account the projected asset/liability position and exposure to changes in interest rates; (v) significant deteriorations in asset quality; and (vi) the source and timing of additional funds to fulfill future capital requirements.

Based on the recent regulatory emphasis placed on banks to assure capital adequacy, our board of directors annually reviews and approves a capital plan. Among other specific objectives, this comprehensive plan: (i) attempts to ensure that we and Peoples Bank remain well capitalized under the regulatory framework for prompt corrective action; (ii) evaluates our capital adequacy exposure through a comprehensive risk assessment; (iii) incorporates periodic stress testing in accordance with the Federal Reserve Board's Supervisory Capital Assessment Program ("SCAP"); (iv) establishes event triggers and action plans to ensure capital adequacy; and (v) identifies realistic and readily available alternative sources for augmenting capital if higher capital levels are required.

Bank regulatory agencies consider capital to be a significant factor in ensuring the safety of a depositor's accounts. These agencies have adopted minimum capital adequacy requirements that include mandatory and discretionary supervisory actions for noncompliance. Our and Peoples Bank's risk-based capital ratios are strong and have consistently exceeded the minimum regulatory capital ratios required for adequately capitalized institutions. Our ratio of Tier 1 capital to risk-weighted assets and off-balance sheet items was 12.3 percent and 12.2 percent at December 31, 2021 and 2020, respectively. Our Total capital ratio was 13.6 percent and 15.1 percent at December 31, 2021 and 2020, respectively. Our and Peoples Bank's common equity Tier I capital to risk-weighted assets ratios were 12.3 percent and 13.8 percent at December 31, 2021 and 12.2 percent and 13.7 percent at December 31, 2020. Our Leverage ratio, which equaled 9.2 percent at December 31, 2021 and 9.3 percent at December 31, 2020, exceeded the minimum of 4.0 percent for capital adequacy purposes. Peoples Bank reported Tier 1 capital, Total capital and Leverage ratios of 13.8 percent, 15.0 percent and 9.6 percent at December 31, 2021, and 13.7 percent, 15.0 percent and 10.1 percent at December 31, 2020. Based on the most recent notification from the FDIC, Peoples Bank was categorized as well capitalized at December 31, 2021. There are no conditions or events since this notification that we believe have changed Peoples Bank's category. For a further discussion of these risk-based capital standards and supervisory actions for noncompliance, refer to the note entitled, "Regulatory matters," in the Notes to Consolidated Financial Statements to this Annual Report.

Stockholders' equity was \$340.1 million or \$47.44 per share at December 31, 2021, and \$316.9 million or \$43.92 per share at December 31, 2020. Stockholders' equity grew \$23.2 million in 2021 as net income offset an increase in accumulated other comprehensive loss, the payment of dividends and the Company's repurchase of its shares.

We declared dividends of \$1.50 per share in 2021, \$1.44 per share in 2020, and \$1.37 per share in 2019. The dividend payout ratio, dividends declared as a percent of net income, equaled 24.9 percent in 2021, 35.8 percent in 2020 and 39.4 percent in 2019. Our board of directors intends to continue paying cash dividends in the future and has declared a cash dividend in the first quarter of 2022 of \$0.39 per share. Our ability to declare and pay dividends in the future is based on our operating results, financial and economic conditions, capital and growth objectives, dividend restrictions and other relevant factors. We rely on dividends received from our subsidiary, Peoples Bank, for payment of dividends to stockholders. Peoples Bank's ability to pay dividends is subject to federal and state regulations. For a further discussion on our ability to declare and pay dividends in the future and dividend restrictions, refer to the note entitled, "Regulatory matters," in the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

Since 2014, our Board of Directors has adopted various common stock repurchase plans whereby we were authorized to repurchase shares of our outstanding common stock through open market purchases. During 2021 we repurchased and retired 54,285 shares for \$2.4 million under the then current plan. We purchased and retired 181,417 shares for \$6.9 million during 2020 and purchased and retired 14,428 shares for \$0.6 million during 2019.

### **Review of Financial Performance:**

Net income for the twelve months ended December 31, 2021, totaled \$43.5 million or \$6.02 per diluted share, a 50.5% increase when compared to \$29.4 million or \$4.00 per diluted share for the comparable period of 2020. The increase in earnings for 2021 is the product of the previously disclosed \$9.6 after-tax gain on the sale of our Visa Class B shares, a decrease to our provision for loan losses of \$5.6 million, primarily due to an adjustment in the year ago period to the economic qualitative factors included in our allowance for loan losses methodology relating to the impact of COVID-19, and an increase to pre-provision net interest income of \$4.8 million due primarily from lower deposit costs. Partially offsetting the increase were a higher income tax provision of \$5.2 million. Return on average assets ("ROAA") and

return on average equity (“ROAE”) were 1.41 percent and 13.34 percent for the year ended December 31, 2021. ROAA was 1.09 percent and ROAE was 9.48 percent for the year ended December 31, 2020.

Tax-equivalent net interest income, a non-GAAP measure, was \$86.1 million in 2021 and \$81.1 million in 2020. Our net interest margin equaled 2.99 percent in 2021 and 3.25 percent in 2020. Noninterest income, including the pre-tax gain of \$12.2 million from the sale of Visa Class B shares, totaled \$25.6 million 2021 and \$16.6 million in 2020. Noninterest expense was \$55.6 million for the year ended December 31, 2021 compared to \$54.9 million for the year ended December 31, 2020. Our productivity is measured by the operating efficiency ratio, a non-GAAP measure, defined as noninterest expense less amortization of intangible assets divided by the total of tax-equivalent net interest income and noninterest income. Our operating efficiency ratio was 55.3 percent in 2021 and 56.0 percent in 2020.

### Visa Class B Common Stock Sale

On October 8, 2021, Peoples Bank agreed to sell 44,982 shares of the Class B common stock of Visa Inc. for a purchase price of \$12.2 million. The shares had no carrying value on the Bank’s balance sheet and, as the Bank had no historical cost basis in the shares, the entire purchase is realized as a pretax gain. The transaction had a positive impact on the Bank’s regulatory capital, which is being used for capital management and to support the Company’s organic growth.

The Bank received 73,333 Class B shares of Visa Inc. as part of its membership interest in March 2008, and 28,351 shares were redeemed in connection with Visa’s initial public offering in 2008. The sale of the remaining 44,982 Class B shares settled in October, 2021 and is included in our 2021 fourth-quarter and year-end results as an after-tax gain of \$9.6 million.

### Non-GAAP Financial Measures (Dollars in thousands)

The following are non-GAAP financial measures, which provide useful insight to the reader of the consolidated financial statements, but should be supplemental to GAAP used to prepare Peoples’ financial statements and should not be read in isolation or relied upon as a substitute for GAAP measures. In addition, Peoples’ non-GAAP measures may not be comparable to non-GAAP measures of other companies. The tax rate used to calculate the fully-taxable equivalent (“FTE”) adjustment was 21% for 2021, 2020, and 2019.

The following table reconciles the non-GAAP financial measures of FTE net interest income for the years ended 2021, 2020 and 2019:

Year ended December 31	2021	2020	2019
Interest income (GAAP)	\$ 94,057	\$ 94,125	\$ 93,381
Adjustment to FTE	1,512	1,306	1,644
Interest income adjusted to FTE (non-GAAP)	95,569	95,431	95,025
Interest expense	9,422	14,324	17,868
Net interest income adjusted to FTE (non-GAAP)	<u>\$ 86,147</u>	<u>\$ 81,107</u>	<u>\$ 77,157</u>



The efficiency ratio is noninterest expenses, less amortization of intangible assets, as a percentage of FTE net interest income plus noninterest income less gains on equity securities and gains on sale of assets. The following table reconciles the non-GAAP financial measures of the efficiency ratio to GAAP for the years ended 2021, 2020, and 2019:

<b>Year ended December 31</b>	<b>2021</b>	<b>2020</b>	<b>2019</b>
<b>Efficiency ratio (non-GAAP):</b>			
Noninterest expense (GAAP)	\$ 55,004	\$ 54,868	\$ 55,642
Less: amortization of intangible assets expense	491	606	730
Noninterest expense adjusted for amortization of assets expense (non-GAAP)	<u>54,513</u>	<u>54,262</u>	<u>54,912</u>
Net interest income (GAAP)	84,635	79,801	75,513
Plus: taxable equivalent adjustment	1,512	1,306	1,644
Noninterest income (GAAP)	25,636	16,642	15,120
Less: net gains (losses) on equity securities	2	(6)	
Less: net gains on sale of assets		918	23
Less: Gain on sale of Visa Class B shares	<u>12,153</u>		
Net interest income (FTE) plus noninterest income (non-GAAP)	<u>\$ 99,628</u>	<u>\$ 96,837</u>	<u>\$ 92,254</u>
Efficiency ratio (non-GAAP)	<u>54.7 %</u>	<u>56.0 %</u>	<u>59.6 %</u>

#### **Net Interest Income:**

Net interest income is the fundamental source of earnings for commercial banks. Moreover, fluctuations in the level of net interest income can have the greatest impact on net profits. Net interest income is defined as the difference between interest revenue, interest and fees earned on interest-earning assets, and interest expense, the cost of interest-bearing liabilities supporting those assets. The primary sources of earning assets are loans and investment securities, while interest-bearing deposits and borrowings comprise interest-bearing liabilities. Net interest income is impacted by:

- Variations in the volume, rate and composition of earning assets and interest-bearing liabilities;
- Changes in general market interest rates; and
- The level of nonperforming assets.

Changes in net interest income are measured by the net interest spread and net interest margin. Net interest spread, the difference between the average yield earned on earning assets and the average rate incurred on interest-bearing liabilities, illustrates the effects changing interest rates have on profitability. Net interest margin, net interest income as a percentage of average earning assets, is a more comprehensive ratio, as it reflects not only the spread, but also the change in the composition of interest-earning assets and interest-bearing liabilities. Tax-exempt loans and investments carry pretax yields lower than their taxable counterparts. Therefore, in order to make the net interest margin analysis more comparable, tax-exempt income and yields are reported in this analysis on a tax-equivalent basis using the prevailing federal statutory tax rate.

Similar to all banks, we consider the maintenance of an adequate net interest margin to be of primary concern. The current economic environment has been very challenging for the banking industry given the adverse impact of the pandemic and interest rates at historical lows. In addition to market rates and competition, nonperforming asset levels are of particular concern for the banking industry and may place additional pressure on net interest margins. Nonperforming assets may stabilize or worsen given the uncertainty of the national and global economies, particularly the labor markets. No assurance can be given as to how general market conditions will change or how such changes will affect net interest income. Therefore, we believe through prudent deposit and loan pricing practices, careful investing, and constant monitoring of nonperforming assets, our net interest margin will remain strong.

We analyze interest income and interest expense by segregating rate and volume components of earning assets and interest-bearing liabilities. The impact changes in the interest rates earned and paid on assets and liabilities, along with changes in the volumes of earning assets and interest-bearing liabilities, have on net interest income are summarized as follows. The net change or mix component, attributable to the combined impact of rate and volume changes within earning assets and interest-bearing liabilities' categories, has been allocated proportionately to the change due to rate and the change due to volume.

**Net interest income changes due to rate and volume** (Dollars in thousands)

	2021 vs 2020 Increase (decrease) attributable to			2020 vs 2019 Increase (decrease) attributable to		
	Total	Rate	Volume	Total	Rate	Volume
Interest income:						
Loans:						
Taxable	\$ (1,189)	\$ (3,860)	\$ 2,671	\$ 1,195	\$ (10,883)	\$ 12,078
Tax-exempt	280	(830)	1,110	(725)	(187)	(538)
Investments:						
Taxable	115	(1,153)	1,268	904	(111)	1,015
Tax-exempt	700	(407)	1,107	(886)	203	(1,089)
Interest-bearing deposits	(31)	(20)	(11)	(26)	(98)	72
Federal funds sold	264	21	243	(56)	(216)	160
Total interest income	139	(6,249)	6,388	406	(11,292)	11,698
Interest expense:						
Money market accounts	(1,550)	(2,324)	774	(1,073)	(2,001)	928
NOW accounts	(539)	(1,439)	900	(200)	(710)	510
Savings accounts	(122)	(193)	71	8	(23)	31
Time deposits less than \$100	(650)	(327)	(323)	71	(174)	245
Time deposits \$100 or more	(1,568)	(1,210)	(358)	(2,062)	(1,468)	(594)
Short-term borrowings	(770)	(270)	(500)	(794)	(1,220)	426
Long-term debt	(442)	337	(779)	(529)	(366)	(163)
Subordinated debt	739	433	306	1,035		1,035
Total interest expense	(4,902)	(4,993)	91	(3,544)	(5,962)	2,418
Net interest income - non-GAAP	\$ 5,041	\$ (1,256)	\$ 6,297	\$ 3,950	\$ (5,330)	\$ 9,280

Tax-equivalent net interest income, a non-GAAP measure, was \$86.1 million in 2021 and \$81.1 million in 2020. Interest and net fees earned on the PPP loans totaled \$7.1 million in 2021. There was a positive volume variance that was partially offset by a negative rate variance. The growth in average earning assets exceeded that of interest-bearing liabilities, and resulted in additional tax-equivalent net interest income, a non-GAAP measure, of \$6.3 million. A rate variance resulted in a decrease in net interest income of \$1.3 million as assets repriced quicker than liabilities.

Average earning assets increased \$382.0 million to \$2.9 billion in 2021 from \$2.5 billion in 2020 and accounted for a \$6.4 million increase in interest income. Average loans, net increased \$97.5 million, which caused interest income to increase \$3.8 million. Average taxable investments increased \$65.0 million comparing 2021 and 2020, which resulted in increased interest income of \$1.3 million while average tax-exempt investments increased \$32.5 million, which resulted in an increase to interest income of \$1.1 million.

Average interest-bearing liabilities grew \$322.9 million to \$2.0 billion in 2021 from \$1.8 billion in 2020 resulting in a net increase in interest expense of \$1.1 million. Large denomination time deposits averaged \$27.5 million less in 2021 and caused interest expense to decrease \$0.4 million. A decrease of \$26.5 million in average time deposits less than \$100 thousand decreased interest expense by \$0.3 million. In addition, interest-bearing transaction accounts, including money market, NOW and savings accounts grew \$377.0 million, which in aggregate caused a \$1.7 million increase in interest expense. Short-term borrowings averaged \$69.7 million less and decreased interest expense \$0.5 million while

long-term debt averaged \$30.6 million less and decreased interest expense by \$0.8 million comparing 2021 and 2020. The issuance of \$33.0 million of subordinated debt during June 2020 caused interest expense to increase \$0.3 million for the full year 2021.

An unfavorable rate variance occurred, as the tax-equivalent yield on earning assets decreased 50 basis points while there was a 33 basis point decrease in the cost of funds. As a result, tax-equivalent net interest income decreased \$1.3 million comparing 2021 and 2020. The tax-equivalent yield on earning assets was 3.32 percent in 2021 compared to 3.82 percent in 2020 resulting in a decrease in interest income of \$6.2 million. With the tax-equivalent yield on the investment portfolio decreasing 42 basis points to 1.94 percent in 2021 from 2.36 percent in 2020, interest income decreased \$1.6 million. The tax-equivalent yield on the loan portfolio decreased 22 basis points to 3.94 percent in 2021 from 4.16 percent in 2020 and resulted in a decrease to interest income of \$4.7 million.

A favorable rate variance was experienced in the cost of funds. We experienced decreases in the rates paid on all major categories of interest-bearing liabilities. Specifically, the cost of non-maturity deposit accounts decreased 25 basis points comparing 2021 and 2020. These decreases resulted in a decrease in interest expense of \$4.0 million. With regard to time deposits, the average rate paid for time deposits less than \$100 thousand decreased 23 basis points while time deposits \$100 thousand or more decreased 68 basis points, which together resulted in a \$1.5 million decrease in interest expense. The average rate paid on short-term borrowings decreased 45 basis points in 2021 when compared to 2020, causing a \$0.3 million decrease in interest expense. Interest expense increased \$0.3 million from a 145 basis point increase in the average rate paid on long-term debt.

The average balances of assets and liabilities, corresponding interest income and expense and resulting average yields or rates paid are summarized as follows. Averages for earning assets include nonaccrual loans. Investment averages include available-for-sale securities at amortized cost. Income on investment securities and loans is adjusted to a tax-equivalent basis, a non-GAAP measure, using the prevailing federal statutory tax rate of 21.0 percent in 2021, 2020 and 2019.

**Summary of net interest income** (Dollars in thousands)

	2021			2020		
	Average Balance	Interest Income/Expense	Average Interest Rate	Average Balance	Interest Income/Expense	Average Interest Rate
<b>Assets:</b>						
Earning assets:						
Loans:						
Taxable	\$ 2,063,168	\$ 82,493	4.00 %	\$ 1,998,178	\$ 83,683	4.19 %
Tax-exempt	157,409	5,009	3.18	124,898	4,729	3.79
Investments:						
Taxable	313,319	5,538	1.77	248,059	5,423	2.19
Tax-exempt	85,200	2,191	2.57	44,607	1,491	3.34
Interest-bearing deposits	11,123	8	0.07	17,288	39	0.23
Federal funds sold	246,891	330	0.13	62,072	66	0.11
Total interest earning assets	2,877,110	95,569	3.32 %	2,495,102	95,431	3.82 %
Less: allowance for loan losses	27,209			25,848		
Other assets	227,293			227,695		
Total assets	<u>\$ 3,077,194</u>			<u>\$ 2,696,949</u>		
<b>Liabilities and Stockholders' Equity:</b>						
Interest-bearing liabilities:						
Money market accounts	\$ 549,169	1,960	0.36 %	\$ 432,621	3,510	0.81 %
NOW accounts	666,885	2,202	0.33	470,701	2,741	0.58
Savings accounts	468,851	382	0.08	404,628	504	0.12
Time deposits less than \$100	128,313	1,416	1.10	154,772	2,066	1.33
Time deposits \$100 or more	172,711	1,350	0.78	200,258	2,918	1.46
Short-term borrowings	13,973	78	0.56	83,716	848	1.01
Long-term debt	7,948	260	3.27	38,560	702	1.82
Subordinated debt	33,000	1,774	5.38	19,295	1,035	5.36
Total interest-bearing liabilities	2,040,850	9,422	0.46 %	1,804,551	14,324	0.79 %
Noninterest-bearing deposits	684,527			555,459		
Other liabilities	25,704			27,389		
Stockholders' equity	326,113			309,550		
Total liabilities and stockholders' equity	<u>\$ 3,077,194</u>			<u>\$ 2,696,949</u>		
Net interest income/spread (non-GAAP)		<u>\$ 86,147</u>	2.86 %		<u>\$ 81,107</u>	3.03 %
Net interest margin			2.99 %			3.25 %
Tax-equivalent adjustments:						
Loans		\$ 1,052			\$ 993	
Investments		460			313	
Total adjustments		<u>\$ 1,512</u>			<u>\$ 1,306</u>	

Note: Average balances were calculated using average daily balances. Interest income on loans includes fees of \$5,933 in 2021, \$3,833 in 2020 and \$1,622 in 2019. The increase in 2020 is primarily due to net fees from PPP loans.

<i>(Dollars in thousands)</i>	2019		
	Average Balance	Interest Income/ Expense	Average Interest Rate
Assets:			
Earning assets:			
Loans:			
Taxable	\$ 1,726,582	\$ 82,488	4.78 %
Tax-exempt	138,975	5,454	3.92
Investments:			
Taxable	201,743	4,519	2.24
Tax-exempt	77,693	2,377	3.06
Interest-bearing deposits	3,493	65	1.86
Federal funds sold	6,023	122	2.03
Total interest earning assets	<u>2,154,509</u>	<u>95,025</u>	4.41 %
Less: allowance for loan losses	22,145		
Other assets	212,989		
Total assets	<u>\$ 2,345,353</u>		
Liabilities and Stockholders' Equity:			
Interest-bearing liabilities:			
Money market accounts	\$ 349,668	4,583	1.31 %
NOW accounts	394,494	2,941	0.75
Savings accounts	380,175	496	0.13
Time deposits less than \$100	137,059	1,995	1.46
Time deposits \$100 or more	230,607	4,980	2.16
Short-term borrowings	62,941	1,642	2.61
Long-term debt	45,253	1,231	2.72
Total interest-bearing liabilities	<u>1,600,197</u>	<u>17,868</u>	1.12 %
Noninterest-bearing deposits	434,676		
Other liabilities	20,290		
Stockholders' equity	290,190		
Total liabilities and stockholders' equity	<u>\$ 2,345,353</u>		
Net interest income/spread		<u>\$ 77,157</u>	3.29 %
Net interest margin (non-GAAP)			3.58 %
Tax-equivalent adjustments:			
Loans		\$ 1,145	
Investments		499	
Total adjustments		<u>\$ 1,644</u>	

### Provision for Loan Losses:

We evaluate the adequacy of the allowance for loan losses account on a quarterly basis utilizing our systematic analysis in accordance with procedural discipline. We take into consideration certain factors such as composition of the loan portfolio, volume of nonperforming loans, volumes of net charge-offs, prevailing economic conditions and other relevant factors when determining the adequacy of the allowance for loan losses account. We make monthly provisions to the allowance for loan losses account in order to maintain the allowance at an appropriate level. The provision for loan losses equaled \$1.8 million in 2021 and \$7.4 million in 2020. The lower provision in the twelve month period ended December 31, 2021 is due to improved credit quality and the resulting reversal of the COVID-19 related asset quality qualitative factor adjustment made in the year ago period in our allowance for loan losses methodology. The higher provision in the year ago period reflected changes made to the qualitative factors related to

economic and credit quality declines resulting from the onset of the coronavirus pandemic and its uncertain economic impact. Based on our most recent evaluation at December 31, 2021, we believe that the allowance was adequate to absorb any known or potential losses in our portfolio as of such date.

**Noninterest Income:**

Our noninterest income for 2021 was \$25.6 million compared with \$16.6 million for the year ago period, an increase of \$9.0 million. Excluding the sale of the Visa Class B shares, noninterest income decreased \$3.2 million or 19.0% due in part to lower revenue generated from commercial loan interest rate swap transactions of \$1.6 million as the number of transactions decreased due to unfavorable market rates. Mortgage banking revenue decreased \$0.6 million in the current period from lower volumes of mortgages sold into the secondary market. The year ago period included a net gain of \$0.9 million from the sale of available-for-sale securities. Service charges, fees, commissions and other are lower in 2021 by \$0.6 million due to a bank owned life insurance benefit of \$0.6 million accrued in the year ago period and a lower Federal Home Loan Bank dividend, partially offset by an increase to our debit card interchange revenue. Wealth management revenue increased \$0.3 million in 2021 due to a higher number of transactions and commissions while fees on fiduciary activities increased \$0.1 million due primarily to market appreciation.

**Noninterest Expense:**

In general, our noninterest expense is categorized into three main groups, including employee-related expense, occupancy and equipment expense and other expenses. Employee-related expenses are costs associated with providing salaries, including payroll taxes and benefits to our employees. Occupancy and equipment expenses, the costs related to the maintenance of facilities and equipment, include depreciation, general maintenance and repairs, real estate taxes, rental expense offset by any rental income and utility costs. Other expenses include general operating expenses such as marketing, other taxes, stationery and supplies, contractual services, insurance, including FDIC assessment and loan collection costs. Several of these costs and expenses are variable while the remainder is fixed. We utilize budgets and other related strategies in an effort to control the variable expenses.

The major components of noninterest expense for the past three years are summarized as follows:

**Noninterest expense** (Dollars in thousands)

<b>Year ended December 31</b>	<b>2021</b>	<b>2020</b>	<b>2019</b>
<b>Salaries and employee benefits expense:</b>			
Salaries and payroll taxes	\$ 25,176	\$ 24,912	\$ 25,930
Employee benefits	4,560	5,223	5,444
Salaries and employee benefits expense	<u>29,736</u>	<u>30,135</u>	<u>31,374</u>
<b>Occupancy and equipment expenses:</b>			
Occupancy expense	6,211	6,230	5,460
Equipment expense	6,637	6,610	6,451
Occupancy and equipment expenses	<u>12,848</u>	<u>12,840</u>	<u>11,911</u>
<b>Other expenses:</b>			
FDIC insurance and assessments	1,117	873	651
Professional fees and outside services	2,137	2,091	1,758
Other taxes	1,336	990	968
Stationery and supplies	910	697	753
Advertising	575	463	873
Amortization of intangible assets	491	606	730
Donations	1,435	1,357	1,441
Other	4,419	4,816	5,183
Other expenses	<u>12,420</u>	<u>11,893</u>	<u>12,357</u>
<b>Total noninterest expense</b>	<b><u>\$ 55,004</u></b>	<b><u>\$ 54,868</u></b>	<b><u>\$ 55,642</u></b>

Salaries and employee benefits expense constitute the majority of our noninterest expenses accounting for 54.1 percent of the total noninterest expense. Salaries and employee benefits expense decreased \$0.4 million or 1.3 percent to \$29.7 million in 2021 from \$30.1 million in 2020. Salaries and payroll taxes increased \$0.3 million or 1.1 percent and employee benefits expense decreased \$0.7 million or 12.7 percent. The higher salary expense in 2021 was due to increases resulting from annual performance-based salary adjustments and additional lending professionals in our expansion markets, partially offset by higher deferred loan origination cost benefit of \$1.4 million due to our origination of PPP loans in 2021. Employee benefits expense was lower due to lower health insurance costs and lower pension expense.

Occupancy and equipment expense was relatively flat when comparing 2021 to 2020. Occupancy expenses were slightly higher due to costs in operating our two newest branches which opened in the fourth quarter. Equipment related expense included a decrease to depreciation expense which offset higher information technology expenses related to our mobile/digital banking solution. We do expect occupancy and equipment expense to increase in 2022 due to a full years' operation of our two newest branch offices and our mobile/digital banking solution.

Other expenses, which consist of merchant transaction expense, FDIC insurance and assessments, professional fees and outside services, other taxes, stationary and supplies, advertising, amortization of intangible assets and all other expenses were \$12.4 million in 2021 and \$11.9 million in 2020. FDIC insurance and assessments was higher by \$0.2 million or 27.9 percent due to the remaining FDIC small bank assessment credit recognized in the first quarter of 2020. Other taxes increased \$0.3 million due to higher Pennsylvania shares tax due to an increase in Peoples Bank stockholder equity. Advertising expenses increased \$0.1 million. The increase in stationery and supplies expenses of \$0.2 million is offset by lower other expenses as postage related costs were re-classified.

**Income Taxes:**

Our income tax expense was \$10.0 million and our effective tax rate was 18.7 percent for the year ended December 31, 2021, an increase from income tax expense of \$4.8 million and an effective tax rate of 14.1 percent for the year ended December 31, 2020. The increases in 2021 were due to higher pre-tax income of \$19.3 million, in part due to the sale of

our Visa Class B shares, the inclusion of a \$0.6 million deferred tax adjustment related to prior periods and the Company's frozen pension plan and \$0.5 million for New Jersey income tax related to our opening a branch office in New Jersey. We utilize loans and investments of tax-exempt organizations to mitigate our tax burden, as interest revenue from these sources is not taxable by the federal government. The tax benefit of tax-exempt income was 2.3% of pre-tax income in 2021 as compared to a 3.0% benefit in 2020.

The effective tax rate in 2021 and 2020 was also influenced by the recognition of investment tax credits related to our limited partnership investments in elderly and low- to- moderate-income residential housing programs which allow us to mitigate our tax burden. By utilizing these credits, we reduced our income tax expense by \$1.1 million in both 2021 and 2020. We anticipate investment tax credits from these investments to be \$0.9 million in 2022. Over the next five years, we will recognize aggregate tax credits from our investments in these projects of \$2.3 million.



## **Management's Discussion and Analysis 2020 versus 2019 (Dollars in thousands, except per share data)**

### **Operating Environment:**

On March 11, 2020, the World Health Organization declared a coronavirus, identified as COVID-19, a global pandemic. In the United States, the rapid spread of the COVID-19 virus invoked various federal, state and local authorities to make emergency declarations and issue executive orders to limit the spread of the disease. Measures included restrictions on travel, limitations on public gatherings, implementation of social distancing protocols, school closings, orders to shelter in place and mandates to close all non-essential businesses to the public. Concerns about the spread of the disease and its anticipated negative impact on economic activity severely disrupted domestic financial markets prompting the Federal Reserve System's FOMC to aggressively cut the target federal funds rate to a range of 0% to 0.25%, including a 50 basis point reduction in the target federal funds rate on March 3, 2020 and an additional 100 basis point reduction on March 15, 2020. In addition, the Federal Reserve rolled out various market support programs to ease the stress on financial markets which continue to be in place.

The rate cuts in March marked the fourth and fifth cut in the overnight rate in the most recent monetary easing cycle, which began in July 2019 after the most recent high for the target range for federal funds of 2.25% to 2.50% which was in December 2018. Overall inflation lags below the FOMC's long-term desired 2% level for items other than food and energy. The consumer price index ("CPI") registered 1.6% for the 12 months ended December 31, 2020, down from 1.7% for the 12 months ended September 30, 2020 but higher than the 1.2% reading for the 12 months ended June 30, 2020. The all items index increased 1.4% for the 12 months ending December 31, 2020, level from the 1.4% registered for the 12 months ending September 30, 2020 and up from the reading for the 12 months ending June 30, 2020 which was 0.6%. As the U.S. economy rebounded from the initial slowdown in the second quarter of 2020 that was brought on by the nationwide shutdown, Gross domestic product ("GDP"), the value of all goods and services produced in the nation, grew in the fourth quarter at a 2.1% annualized rate, in line with consensus forecasts, which followed a third quarter 2020 reading of a 33.4% annualized rate, better than the consensus forecast of 32.0% for the quarter. Personal consumption increased by 1.7% during the fourth quarter.

The employment situation deteriorated in New York and Pennsylvania and in all of the thirteen counties representing our market areas in Pennsylvania and New York from one year ago when comparing December 31, 2020 to December 31, 2019. Projections for our local market unemployment are not readily available, however the most current economic statistics as of January 31, 2021 show continuing jobless claims of over 4.5 million. This indicates a significant improvement from the peak of 17 million jobless claims from 2020, but it remains elevated as does the unemployment rate at 8.1% on a national level per the latest report from the Bureau of Labor Statistics at December 31, 2020. By comparison, the unemployment rate was 8.8% at quarter end September 30, 2020 and 13.0% at quarter end June 30, 2020. Prior to the economic fallout of the COVID-19 pandemic, the highest recorded unemployment rate in recent history was 9.9% in 2009 during the Great Recession. As the pandemic continues to remain a focus of the economic recovery, elevated unemployment rates could have an adverse effect on our credit quality and may result in increased credit losses within the loan portfolio in future periods. On a national level, as with our regional and local economies, employment conditions deteriorated in 2020. The civilian labor force decreased 4.0 million, while the number of people employed decreased 8.9 million in 2020. As a result, the annual unemployment rate for the U.S. increased in 2020 when compared to 2019.

National, Pennsylvania, New York and our market area's non-seasonally-adjusted annual unemployment rates in 2020 and 2019, are summarized as follows:

	<u>2020</u>	<u>2019</u>
United States	8.1 %	3.7 %
New York	10.0	4.0
Pennsylvania	9.1	4.1
Broome County	8.3	4.6
Bucks County	8.4	3.6
Lackawanna County	9.9	4.6
Lebanon County	7.9	
Lehigh County	9.5	4.3
Luzerne County	11.2	5.4
Monroe County	11.6	5.1
Montgomery County	7.8	3.3
Northampton County	9.0	4.2
Schuylkill County	9.3	5.1
Susquehanna County	7.5	4.1
Wayne County	9.5	4.4
Wyoming County	8.7 %	4.6 %

With respect to the banking industry, net income for all FDIC-insured banks in 2020 totaled \$147.9 billion, a decrease of \$84.9 billion or 36.5 percent from 2019. The decline was primarily attributable to the increased provisioning due to the decline in economic conditions in the first six months of 2020. Approximately 53.7 percent of all institutions reported higher net income in 2020, while only 3.9 percent reported net losses, up slightly from last year's reported 3.6 percent unprofitable institutions. Loan loss provisions of \$132.2 billion in 2020 were \$77.1 billion or 140.0 percent more than banks set aside in 2019. Net interest income decreased for the first time in seven years, by \$20.0 billion or 3.7 percent. Noninterest income was \$15.9 billion or 6.0 percent above the level of 2019. Realized gains on sales of investments were \$8.1 billion compared to \$4.0 billion in 2019. Total noninterest expense increased \$32.9 billion or 6.9 percent comparing 2020 and 2019. The return on average assets for 2020 was 0.72 percent compared to 1.29 percent in 2019.

#### **Review of Financial Position:**

Total assets, loans and deposits were \$2.9 billion, \$2.2 billion and \$2.4 billion, respectively, at December 31, 2020. Total assets, loans and deposits grew 16.5 percent, 12.4 percent and 23.6 percent, respectively, compared to 2019 year-end balances.

The loan portfolio consisted of \$1.8 billion of business loans, including commercial and commercial real estate loans, and \$360.7 million in retail loans, including residential mortgage and consumer loans at December 31, 2020. Total investment securities were \$303.3 million at December 31, 2020, including \$295.9 million of investment securities classified as available-for sale and \$7.2 million classified as held-to-maturity. Total deposits consisted of \$622.5 million in noninterest-bearing deposits and \$1.8 billion in interest-bearing deposits at December 31, 2020.

Stockholders' equity equaled \$316.9 million, or \$43.92 per share, at December 31, 2020, and \$299.0 million, or \$40.47 per share, at December 31, 2019. Our equity to asset ratio was 11.0 percent and 12.1 percent at those respective period ends. Dividends declared for the 2020 amounted to \$1.44 per share representing 35.8 percent of net income.

Nonperforming assets equaled \$10.5 million or 0.48 percent of loans, net and foreclosed assets at December 31, 2020, as the balance remained the same, however, the percentage was lower when compared to \$10.5 million or 0.54 percent at December 31, 2019. The allowance for loan losses equaled \$27.3 million or 1.26 percent of loans, net, at December 31, 2020, compared to \$22.7 million or 1.17 percent at year-end 2019. Loans charged-off, net of recoveries equaled \$2.7 million or 0.13 percent of average loans in 2020, compared to \$4.8 million or 0.26 percent of average loans in 2019.

## **Investment Portfolio:**

Primarily, our investment portfolio provides a source of liquidity needed to meet expected loan demand and generates a reasonable return in order to increase our profitability. Additionally, we utilize the investment portfolio to meet pledging requirements and reduce income taxes. At December 31, 2020, our portfolio consisted primarily of short-term U.S. Treasury and government agency securities, which provide a source of liquidity and intermediate-term, tax-exempt state and municipal obligations, which mitigate our tax burden.

Investment securities decreased \$35.3 million, to \$303.3 million at December 31, 2020, from \$338.6 million at December 31, 2019. At December 31, 2020, the investment portfolio consisted of \$295.9 million of investment securities classified as available-for-sale and \$7.2 million classified as held-to-maturity. Investment cash flow was used to fund the loan pipeline prior to the economic slowdown brought on by COVID-19 during the first quarter of 2020. For the majority of the remainder of 2020, investment cash flow was directed to overnight federal funds sold, as management focused on increasing liquidity in the uncertain economic environment. As the level of overnight funds increased, our Asset Liability Committee recommended a strategy to deploy a portion of those funds back into the investment portfolio through purchases of primarily taxable and tax-free municipal bonds and mortgage-backed securities to mitigate risk in a flat and down rate environment. Security purchases totaled \$107.2 million in 2020, with purchases consisting of longer term taxable and tax-exempt municipal securities and mortgage-backed securities. Investment purchases in 2019 amounted to \$124.5 million.

Repayments of investment securities totaled \$85.0 million in 2020 and \$58.2 million in 2019. During the first quarter of 2020, the Company sold \$26.5 million of low-yielding short-term municipal bonds resulting in a gain of \$267 thousand. The proceeds were used to fund higher yielding loans. Additionally, two mortgage-backed securities were sold during the second half of 2020 with proceeds totaling \$38.3 million and gains recognized of \$651 thousand due to favorable market rates. Sales of \$9.7 million of low-yielding municipal securities during 2019 resulted in a gain of \$23 thousand. We continually analyze the investment portfolio with respect to its exposure to various risk elements.

Investment securities averaged \$292.7 million and equaled 11.7 percent of average earning assets in 2020, compared to \$279.4 million and 13.0 percent of average earning assets in 2019. The tax-equivalent yield on the investment portfolio decreased eleven basis points to 2.36 percent in 2020 from 2.47 percent in 2019. The decrease in the tax-equivalent yield is due primarily to cash flow from maturing and called bonds being reinvested into lower market rates.

## **Loan Portfolio:**

Overall, total loans increased \$239.7 million or 12.4 percent in 2020 to \$2.2 billion at December 31, 2020. Excluding PPP loans, loan growth totaled \$50.0 million or 2.6%. Business loans, including commercial loans and commercial real estate loans, were \$1.8 billion or 83.4 percent of total loans at December 31, 2020, and \$1.5 billion or 79.2 percent at year-end 2019. Residential mortgages and consumer loans totaled \$360.7 million or 16.6 percent of total loans at year-end 2020 and \$403.9 million or 20.8 percent at year-end 2019. Loan growth, excluding PPP loans, was significantly affected by the economic slowdown resulting from COVID-19. Total loan growth, excluding PPP loans, of \$50.0 million was primarily attributable to increases in our commercial real estate portfolio which grew \$126.6 million in 2020 due to continued success of our strategy to expand in larger markets with strong growth potential, and strong organic growth in our legacy markets. Our expansion strategy commenced during 2014 in the Lehigh Valley with a community banking office and team of dedicated lenders and has expanded with two additional branch offices and additional teams of experienced lenders and credit professionals. Growth is also due to our presence in the Greater Delaware Valley, first by opening a branch office in King of Prussia in 2016, and most recently during the first quarter of 2020 with the opening of a branch in Doylestown and recruitment of two experienced lenders. Further growth was attained by our entrance into Central Pennsylvania with a branch office in Lebanon, staffed with a team of lending professionals during the middle of 2018. Based on the customer service oriented philosophy of our organization along with the commitment of these employees, we continue to be well received in these new markets as we are in our existing markets.

Loans averaged \$2.1 billion in 2020, compared to \$1.9 billion in 2019. Taxable loans averaged \$2.0 billion, while tax-exempt loans averaged \$124.9 million in 2020. The loan portfolio continues to play the prominent role in our earning

asset mix. As a percentage of earning assets, average loans equaled 85.1 percent in 2020, a decrease from 86.6 percent in 2019.

#### **Asset Quality:**

Nonperforming assets consist of nonperforming loans and foreclosed assets. Nonperforming loans include nonaccrual loans, troubled debt restructured loans and accruing loans past due 90 days or more. For a discussion of our policy regarding nonperforming assets and the recognition of interest income on impaired loans, refer to the notes entitled, “Summary of significant accounting policies — Nonperforming assets,” and “Loans, net and allowance for loan losses” in the Notes to Consolidated Financial Statements to this Annual Report which are incorporated in this item by reference.

We maintain the allowance for loan losses at a level we believe adequate to absorb probable credit losses related to individually evaluated loans, as well as probable incurred losses inherent in the remainder of the loan portfolio as of the balance sheet date. The balance in the allowance for loan losses account is based on past events and current economic conditions. We employ the FFIEC Interagency Policy Statement, as amended, and GAAP in assessing the adequacy of the allowance account. Under GAAP, the adequacy of the allowance account is determined based on the provisions of FASB Accounting Standards Codification (“ASC”) 310 for loans specifically identified to be individually evaluated for impairment and the requirements of FASB ASC 450, for large groups of smaller-balance homogeneous loans to be collectively evaluated for impairment.

The allowance for loan losses increased \$4.6 million to \$27.3 million at December 31, 2020, from \$22.7 million at the end of 2019. The increase resulted from a provision for loan losses of \$7.4 million less net loans charged-off of \$2.7 million. Changes made during the first six months of 2020 to the qualitative factors, which related to economic decline resulting from the adverse impact of the COVID-19 crisis, was the primary reason for the higher provision. Commercial loan charge-offs were \$2.8 million and included a \$1.1 partial write down of a specific credit relationship, which has been subsequently paid off in January 2021, a charge-off of \$0.6 million to a specific commercial credit during the first quarter and \$0.9 million related to a group of small business lines of credit in our Greater Delaware Valley market. Commercial loan recoveries increased \$0.5 million and included \$0.2 million related to the group of small business lines of credit in the Greater Delaware Valley market and \$0.2 million on a separate credit. We charged-off \$3.3 million of commercial loans in 2019 substantially all of which were in the fourth quarter. Included in this amount was \$2.3 million related to certain small business lines of credit in our Greater Delaware Valley market and \$1.0 million of other commercial loan relationships.

Past due loans not satisfied through repossession, foreclosure or related actions are evaluated individually to determine if all or part of the outstanding balance should be charged against the allowance for loan losses account. Any subsequent recoveries are credited to the allowance account. Net loans charged-off decreased \$2.1 million to \$2.7 million in 2020 from \$4.8 million in 2019. Net charge-offs, as a percentage of average loans outstanding, equaled 0.13 percent in 2020 and 0.26 percent in 2019.

The allowance for loan losses account increased \$4.6 million to \$27.3 million at December 31, 2020, compared to \$22.7 million at December 31, 2019. The specific portion of the allowance for impairment of loans individually evaluated under FASB ASC 310 increased \$0.4 million to \$1.2 million at December 31, 2020, from \$0.8 million at December 31, 2019 and the formula portion of the allowance for loans collectively evaluated for impairment under FASB ASC 450, increased \$4.2 million to \$26.1 million at December 31, 2020, from \$21.9 million at December 31, 2019. The increase in the specific portion of the allowance was a result of a decrease in measured impairment for collateral dependent loans. The increase in the formula portion was primarily the result of a significant increase in volume and an increase in the historical loss factor for commercial loans, due to the increase in charge-offs during 2019.

The coverage ratio, the allowance for loan losses, as a percentage of nonperforming loans, is an industry ratio used to test the ability of the allowance account to absorb potential losses arising from nonperforming loans. The coverage ratio was 277.0 percent at December 31, 2020 and 225.0 percent at December 31, 2019. We believe that our allowance was adequate to absorb probable credit losses at December 31, 2020.

## **Deposits:**

Our deposit base is the primary source of funds to support our operations. We offer a variety of deposit products to meet the needs of our individual and commercial customers. Total deposits grew \$465.6 million or 23.6 percent to \$2.4 billion at the end of 2020. The increase in deposits is due to organic growth in customer relationships throughout all our markets, higher customer savings rates, and PPP loan proceeds retained coupled with additional deposits by our commercial borrowers. Total deposits include \$23.0 million of brokered certificates of deposit. Noninterest-bearing deposits grew \$159.2 million or 34.4 percent while interest-bearing deposits increased \$306.4 million or 20.3 percent in 2020. Noninterest-bearing deposits represented 25.5 percent of total deposits while interest-bearing deposits accounted for 74.5 percent of total deposits at December 31, 2020. Comparatively, noninterest-bearing deposits and interest-bearing deposits represented 23.5 percent and 76.5 percent of total deposits at year end 2019. With regard to noninterest-bearing deposits, personal checking accounts increased \$61.1 million or 28.8 percent, while commercial checking accounts increased \$98.6 million or 39.3 percent. The increase in noninterest-bearing deposits is essential in attempting to keep our overall cost of funds low given the pressure on our net interest margin from the decrease in short-term market rates.

With regard to interest-bearing deposits, interest-bearing transaction accounts, which include money market accounts and NOW accounts, and savings accounts, increased \$356.2 million in 2020. Commercial interest-bearing transaction accounts increased \$215.8 million, while personal interest-bearing transaction accounts increased \$79.5 million. Savings accounts increased \$61.0 million during 2020 as customers saved a higher percentage of the government stimulus in safe liquid accounts. The strong growth in our non-maturity deposits was due to continuing our strategic initiative to grow our public fund deposits and continued organic growth in all our markets. Total time deposits decreased \$49.8 million to \$319.7 million at December 31, 2020 from \$369.5 million at December 31, 2019. The decrease was due to depositors shifting funds to more liquid accounts and the redemption of a few large municipal accounts.

Total deposits averaged \$2.2 billion in 2020 and \$1.9 billion in 2019, increasing \$291.8 million or 15.1 percent comparing 2020 to 2019. Average noninterest-bearing deposits increased \$120.8 million, while average interest-bearing accounts grew \$171.0 million. Average interest-bearing transaction deposits, including money market and NOW, and savings accounts, increased \$183.6 million while average total time deposits decreased \$12.6 million when comparing 2020 and 2019.

Our cost of interest-bearing deposits decreased 30 basis points to 0.71 percent in 2020 from 1.01 percent in 2019. Specifically, the cost of money market accounts decreased 50 basis points to 0.81 percent from 1.31 percent, NOW accounts decreased 17 basis points and the cost of time deposits decreased 50 basis points to 1.40 percent comparing 2020 and 2019. The decreases to the cost of our interest-bearing deposits was the result of our initiative to reduce premium rates being paid on core deposit relationships and the reduction of stated rates across all deposit products. The reductions are directly related to the FOMC's decision to decrease the target federal funds rate 225 basis points from July 2019 to March 2020, first in response to economic slowdown and most recently due to the COVID-19 crisis. We expect our cost of funds to continue to decline as time deposits mature and reinvest into lower rates and we continue to lower all our interest-bearing deposit rates to mitigate compression to our net interest margin.

Volatile deposits, time deposits \$100 or more, averaged \$200.3 million in 2020, a decrease of \$30.3 million or 13.2 percent from \$230.6 million in 2019. Our average cost of these funds decreased 70 basis points to 1.46 percent in 2020, from 2.16 percent in 2019. This type of funding is susceptible to withdrawal by the depositor as they are particularly price sensitive and are therefore not considered to be a strong source of liquidity.

## **Market Risk Sensitivity:**

With respect to evaluating our exposure to IRR on earnings, we utilize a gap analysis model that considers repricing frequencies of RSA and RSL. Gap analysis attempts to measure our interest rate exposure by calculating the net amount of RSA and RSL that reprice within specific time intervals. A positive gap occurs when the amount of RSA repricing in a specific period is greater than the amount of RSL repricing within that same time frame and is indicated by a RSA/RSL ratio greater than 1.0. A negative gap occurs when the amount of RSL repricing is greater than the amount of RSA and is indicated by a RSA/RSL ratio less than 1.0. A positive gap implies that earnings will be impacted favorably if interest

rates rise and adversely if interest rates fall during the period. A negative gap tends to indicate that earnings will be affected inversely to interest rate changes.

At December 31, 2020, we had cumulative one-year RSA/RSL ratio of 1.39, a positive gap. At December 31, 2019, we had cumulative one-year RSA/RSL of 0.98, a negative gap. As previously mentioned, a positive gap indicates that if interest rates increase, our earnings would likely be favorably impacted. Given the current economic conditions and the action of the FOMC to cut short-term rates to near zero during the first quarter of 2020 and their commitment to hold rates near zero for the foreseeable future, the focus of ALCO has been to maintain a well-balanced IRR position in order to safeguard future earnings during this historical low-rate environment and from potential risk to falling interest rates. During 2020 ALCO took steps to reduce our positive gap position and guard against rates unchanged or down through the origination of fixed rate loans and the investment in longer term, fixed rate municipal securities and longer duration U.S. government-sponsored mortgage-backed securities. Additionally, an initiative to reduce funding costs was executed to mitigate the adverse impact to net interest income from the low rates ALCO will continue to focus efforts on strategies in 2021 in an attempt to maintain a positive gap position between RSA and RSL. However, these forward-looking statements are qualified in the aforementioned section entitled “Forward-Looking Discussion” in this Management’s Discussion and Analysis.

The change in our cumulative one-year ratio from the previous year-end resulted from a \$427.4 million or 46.0 percent increase in RSA partially offset by a \$30.6 million or 3.2 percent increase in RSL maturing or repricing within one year. The increase in RSA resulted primarily from a \$247.7 million increase in total loans, net of unearned income, resulting from an increase in commercial lending, which primarily involves loans with adjustable-rate terms that reprice in the near term. An increase of \$183.0 million in federal funds sold from a surge in non-maturity deposits and a cautious approach to adding longer term assets at historically low rates also resulted in the higher RSA when comparing 2020 to 2019.

With respect to the \$30.6 million increase in RSL maturing or repricing within a twelve month time horizon, non-maturity deposits increased \$181.0 million due to customers seeking liquid accounts and saving at a higher percentage due to the economic uncertainty of the pandemic. The growth in deposits resulted in lower short-term borrowings of \$102.1 million. Time deposits \$100 thousand or more also declined when comparing year end 2020 to 2019 as a number of large accounts matured and customers sought more liquid alternatives.

### **Liquidity:**

We employ a number of analytical techniques in assessing the adequacy of our liquidity position. One such technique is the use of ratio analysis to illustrate our reliance on noncore funds to fund our investments and loans maturing after 2020. At December 31, 2020, our noncore funds consisted of time deposits in denominations of \$100 thousand or more, short-term borrowings, and long-term and subordinated debt. Large denomination time deposits are particularly not considered to be a strong source of liquidity since they are very interest rate sensitive and are considered to be highly volatile. At December 31, 2020, our net noncore funding dependence ratio, the difference between noncore funds and short-term investments to long-term assets, was 2.8 percent. Our net short-term noncore funding dependence ratio, noncore funds maturing within one year, less short-term investments to long-term assets equaled negative 1.3 percent due to our short-term investments being greater than the non-core funding. Comparatively, our ratios equaled 17.8 percent and 14.4 percent at the end of 2019, which indicates a significant decrease in our reliance on noncore funds in 2020. Moreover, our basic liquidity surplus ratio, defined as liquid assets less short-term potentially volatile liabilities as a percentage of total assets, increased to 8.7 percent at December 31, 2020, from 5.7 percent at December 31, 2019. We believe that by supplying adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, we can ensure adequate liquidity to support future growth.

The Consolidated Statements of Cash Flows present the change in cash and cash equivalents from operating, investing and financing activities. Cash and cash equivalents consist of cash on hand, cash items in the process of collection, noninterest-bearing and interest-bearing deposits with other banks and federal funds sold. Cash and cash equivalents increased \$197.0 million for the year ended December 31, 2020. For the year ended December 31, 2019, cash and cash

equivalents decreased \$1.5 million. During 2020, cash provided by operating and financing activities more than offset cash used in investing activities.

Operating activities provided net cash of \$37.2 million in 2020 and \$37.1 million in 2019. Net income, adjusted for the effects of noncash expenses such as depreciation, amortization and accretion of tangible and intangible assets and investment securities, and the provision for loan losses, is the primary source of funds from operations.

Net cash provided by financing activities equaled \$361.1 million in 2020. Net cash provided by financing activities was \$146.2 million in 2019. Deposit gathering, which is our predominant financing activity, increased in both 2020 and 2019. Deposit gathering provided a net cash inflow in 2020 of \$465.6 million and \$96.5 million in 2019. Short-term borrowings decreased net cash by \$102.2 million in 2020 while a net increase in short-term borrowings of \$65.6 million increased net cash provided by financing activities in 2019. Deposit gathering in 2020 was also partially offset by a \$18.0 million net decrease in long-term debt as well as cash dividends paid of \$10.5 million. The issuance of \$33.0 million of subordinated debt in 2020 also contributed to the increase. In 2019, deposit gathering was partially offset by a net \$5.2 million repayments of long-term debt and cash dividends paid of \$10.1 million.

Our primary investing activities involve transactions related to our investment and loan portfolios. Net cash used in investing activities totaled \$201.2 million in 2020. Net cash used in investing activities was \$184.7 million in 2019. Net cash used in lending activities was \$241.3 million in 2020, an increase from \$120.0 million in 2019. Activities related to our investment portfolio provided net cash of \$43.0 million in 2020 and used cash of \$56.6 million in 2019.

#### **Capital Adequacy:**

Bank regulatory agencies consider capital to be a significant factor in ensuring the safety of a depositor's accounts. These agencies have adopted minimum capital adequacy requirements that include mandatory and discretionary supervisory actions for noncompliance. Our and Peoples Bank's risk-based capital ratios are strong and have consistently exceeded the minimum regulatory capital ratios required for adequately capitalized institutions. Our ratio of Tier 1 capital to risk-weighted assets and off-balance sheet items was 12.2 percent and 11.9 percent at December 31, 2020 and 2019, respectively. Our Total capital ratio was 15.1 percent and 13.0 percent at December 31, 2020 and 2019, respectively. The increase in the total capital ratio is due to the issuance of \$33.0 million of subordinated debt which qualified as Tier 2 capital. Our and Peoples Bank's common equity Tier I capital to risk-weighted assets ratios were 12.2 percent and 13.7 percent at December 31, 2020 and 11.9 percent and 11.6 percent at December 31, 2019. Our Leverage ratio, which equaled 9.3 percent at December 31, 2020 and 10.1 percent at December 31, 2019, exceeded the minimum of 4.0 percent for capital adequacy purposes. Peoples Bank reported Tier 1 capital, Total capital and Leverage ratios of 13.7 percent, 15.0 percent and 10.1 percent at December 31, 2020, and 11.6 percent, 12.8 percent and 9.9 percent at December 31, 2019. Based on the most recent notification from the FDIC, Peoples Bank was categorized as well capitalized at December 31, 2020. There are no conditions or events since this notification that we believe have changed Peoples Bank's category. For a further discussion of these risk-based capital standards and supervisory actions for noncompliance, refer to the note entitled, "Regulatory matters," in the Notes to Consolidated Financial Statements to this Annual Report.

Stockholders' equity was \$316.9 million or \$43.92 per share at December 31, 2020, and \$299.0 million or \$40.47 per share at December 31, 2019. Stockholders' equity grew \$17.9 million in 2020 as net income and a decrease in accumulated other comprehensive loss offset the payment of dividends and the Company's repurchase of its shares.

#### **Review of Financial Performance:**

Net income totaled \$29.4 million or \$4.00 per diluted share in 2020 an increase of 14.1% when compared to \$25.7 million or \$3.47 per diluted share in 2019. The increase in earnings in 2020 is the result of higher pre-provision net interest income of \$4.3 million due primarily to lower funding costs, higher noninterest income of \$1.5 million and lower noninterest expense of \$0.7 million which were partially offset by an increase of \$1.3 million to the provision for loan losses and a \$1.7 million increase to the income tax provision. The results for 2020 include a \$0.9 million net gain on the

sale of debt securities included in noninterest income. Return on average assets (“ROAA”) and return on average equity (“ROAE”) were 1.09 percent and 9.48 percent for the year ended December 31, 2020. ROAA was 1.10 percent and ROAE was 8.87 percent for the year ended December 31, 2019.

Tax-equivalent net interest income, a non-GAAP measure, was \$81.1 million in 2020 and \$77.2 million in 2019. Our net interest margin equaled 3.25 percent in 2020 and 3.58 percent in 2019. Noninterest income totaled \$16.6 million in 2020 and \$15.1 million in 2019. Noninterest expense was \$54.9 million for the year ended December 31, 2020 compared to \$55.6 million for the year ended December 31, 2019. Our productivity is measured by the operating efficiency ratio, a non-GAAP measure, defined as noninterest expense less amortization of intangible assets divided by the total of tax-equivalent net interest income and noninterest income. Our operating efficiency ratio was 56.0 percent in 2020 and 59.6 percent in 2019.

### **Net Interest Income:**

Tax-equivalent net interest income, a non-GAAP measure, was \$81.1 million in 2020 and \$77.2 million in 2019. Interest and net fees earned on the PPP loans totaled \$3.8 million in 2020. There was a positive volume variance that was partially offset by a negative rate variance. The growth in average earning assets exceeded that of interest-bearing liabilities, and resulted in additional tax-equivalent net interest income, a non-GAAP measure, of \$9.3 million. A rate variance resulted in a decrease in net interest income of \$5.3 million as assets repriced quicker than liabilities.

Average earning assets increased \$340.6 million to \$2.5 billion in 2020 from \$2.2 billion in 2019 and accounted for a \$11.7 million increase in interest income. Average loans, net increased \$257.5 million, including \$148.3 million of PPP loans, which caused interest income to increase \$11.5 million. Average taxable investments increased \$46.3 million comparing 2020 and 2019, which resulted in increased interest income of \$1.0 million while average tax-exempt investments decreased \$33.1 million, which resulted in a decrease to interest income of \$1.1 million.

Average interest-bearing liabilities grew \$204.4 million to \$1.8 billion in 2020 from \$1.6 billion in 2019 resulting in a net increase in interest expense of \$2.4 million. Large denomination time deposits averaged \$30.3 million less in 2020 and caused interest expense to decrease \$0.6 million. An increase of \$17.7 million in average time deposits less than \$100 thousand increased interest expense by \$0.2 million. In addition, interest-bearing transaction accounts, including money market, NOW and savings accounts grew \$183.6 million, which in aggregate caused a \$1.5 million increase in interest expense. Short-term borrowings averaged \$20.8 million more and increased interest expense \$0.4 million while long-term debt averaged \$6.7 million less and decreased interest expense by \$0.2 million comparing 2020 and 2019. The issuance of \$33.0 million of subordinated debt during June 2020 caused interest expense to increase \$1.0 million.

An unfavorable rate variance occurred, as the tax-equivalent yield on earning assets decreased 59 basis points while there was a 33 basis point decrease in the cost of funds. As a result, tax-equivalent net interest income decreased \$5.3 million comparing 2020 and 2019. The tax-equivalent yield on earning assets was 3.82 percent in 2020 compared to 4.41 percent in 2019 resulting in a decrease in interest income of \$11.3 million. With the tax-equivalent yield on the investment portfolio decreasing 11 basis points to 2.36 percent in 2020 from 2.47 percent in 2019, interest income decreased \$0.1 million. The tax-equivalent yield on the loan portfolio decreased 55 basis points to 4.16 percent in 2020 from 4.71 percent in 2019 and resulted in a decrease to interest income of \$11.1 million.

A favorable rate variance was experienced in the cost of funds. We experienced decreases in the rates paid on all major categories of interest-bearing liabilities. Specifically, the cost of money market and NOW accounts decreased 50 basis points and 17 basis points comparing 2020 and 2019. These decreases resulted in a decrease in interest expense of \$2.7 million. With regard to time deposits, the average rate paid for time deposits less than \$100 thousand decreased 13 basis points while time deposits \$100 thousand or more decreased 70 basis points, which together resulted in a \$1.6 million decrease in interest expense. The average rate paid on short-term borrowings decreased 160 basis points in 2020 when compared to 2019, causing a \$1.2 million decrease in interest expense. Interest expense decreased \$0.4 million from a 90 basis point decrease in the average rate paid on long-term debt.



### **Provision for Loan Losses:**

We evaluate the adequacy of the allowance for loan losses account on a quarterly basis utilizing our systematic analysis in accordance with procedural discipline. We take into consideration certain factors such as composition of the loan portfolio, volume of nonperforming loans, volumes of net charge-offs, prevailing economic conditions and other relevant factors when determining the adequacy of the allowance for loan losses account. We make monthly provisions to the allowance for loan losses account in order to maintain the allowance at an appropriate level. The provision for loan losses equaled \$7.4 million in 2020 and \$6.1 million in 2019. The higher provision for loan losses in 2020 resulted from changes made during the first six months to the qualitative factors, which related to economic decline resulting from the adverse impact of the COVID-19 crisis. Based on our most recent evaluation at December 31, 2020, we believe that the allowance was adequate to absorb any known or potential losses in our portfolio as of such date.

### **Noninterest Income:**

Our noninterest income increased \$1.5 million or 10.1 percent to \$16.6 million in 2020 from \$15.1 million in 2019. The increase in 2020 was driven primarily by higher mortgage banking revenue of \$1.0 million due to increased refinance activity from low market rates which resulted in higher volume of loans sold into the secondary market. We also realized a \$0.9 million net gain on the sale of investment securities in 2020 while the 2019 results included gains of \$0.2 million. Commercial loan interest rate swap revenue was higher by \$0.5 million due to an increased number and volume of transactions during 2020 compared to 2019. Service charges, fees and commissions decreased \$0.4 million due to lower service charges on consumer and commercial deposit accounts of \$0.8 million from a noticeable reduction in transaction volumes related to COVID-19. Bank owned life insurance (“BOLI”) death benefit proceeds included in service charges, fees and commissions for 2020 totaling \$0.6 million partially offset the reduction. Merchant revenue declined \$0.1 million or 15.3% and wealth management revenue declined \$0.2 million or 15.9% due to lower transaction volumes in part to COVID-19.

### **Noninterest Expense:**

Noninterest expense was \$54.9 million for the year ended December 31, 2020 compared to \$55.6 million for the year ended December 31, 2019.

Salaries and employee benefits expense constitute the majority of our noninterest expenses accounting for 54.9 percent of the total noninterest expense. Salaries and employee benefits expense decreased \$1.2 million or 3.9 percent to \$30.1 million in 2020 from \$31.4 million in 2019. Salaries and payroll taxes decreased \$1.0 million or 3.9 percent and employee benefits expense decreased \$0.2 million or 4.1 percent. The lower salary expense in 2020 was primarily due to deferred loan origination cost benefit which increased \$1.4 million due to our origination of PPP loans in 2020. This higher benefit was partially offset by increases due to annual performance-based salary adjustments and additional lending professionals in our expansion markets. Employee benefits expense was lower due to lower health insurance costs and lower pension expense.

Occupancy and equipment expense increased \$0.9 million or 7.8 percent to \$12.8 million in 2020 from \$11.9 million in 2019 due specifically to a 16.3 percent increase in equipment expense. The increase in equipment-related expenses was due in part to an investment in a software solution to streamline our PPP loan origination process, additional computer hardware to enable a larger percentage of our workforce to work remotely, and an investment in a new mobile/digital banking solution.

Other expenses, which consist of merchant transaction expense, FDIC insurance and assessments, professional fees and outside services, other taxes, stationary and supplies, advertising, amortization of intangible assets and all other expenses were \$11.9 million in 2020 and \$12.4 million in 2019. FDIC insurance and assessments was higher by \$0.2 million or 34.1 percent primarily attributed to the receipt of a credit in 2019 related to the Deposit Insurance Fund’s (DIF) minimum reserve ratio assessment. Professional fees and outside services increased \$0.3 million due to legal work related to loan

workouts and PPP loans. Advertising expenses decreased \$0.4 million and other expenses, which include employee education, travel and entertainment expenses, decreased \$0.4 million due to COVID-19.

**Income Taxes:**

Our income tax expense was \$4.8 million in 2020 and \$3.2 million in 2019. We utilize loans and investments of tax-exempt organizations to mitigate our tax burden, as interest revenue from these sources is not taxable by the federal government. As a result, our effective tax rate was 14.1 percent in 2020 and 10.9 percent in 2019.

The effective tax rate in 2020 and 2019 was also influenced by the recognition of investment tax credits related to our limited partnership investments in elderly and low- to- moderate-income residential housing programs which allow us to mitigate our tax burden. By utilizing these credits, we reduced our income tax expense by \$1.1 million in both 2020 and 2019. We anticipate investment tax credits from these investments to be \$1.1 million again in 2021. Over the next five years, we will recognize aggregate tax credits from our investments in these projects of \$3.4 million.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Market risk is the risk to our earnings and/or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. Our exposure to market risk is primarily interest rate risk (“IRR”), which arises from our lending, investing and deposit gathering activities. Our market risk sensitive instruments consist of derivative and non-derivative financial instruments, none of which are entered into for trading purposes. During the normal course of business, we are not exposed to foreign exchange risk or commodity price risk. Our exposure to IRR can be explained as the potential for change in reported earnings and/or the market value of net worth. Variations in interest rates affect the underlying economic value of assets, liabilities and off-balance sheet items. These changes arise because the present value of future cash flows, and often the cash flows themselves, change with interest rates. The effects of the changes in these present values reflect the change in our underlying economic value, and provide a basis for the expected change in future earnings related to interest rates. Interest rate changes affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. IRR is inherent in the role of banks as financial intermediaries.

A bank with a high degree of IRR may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities. Interest rate risk is the risk of loss to future earnings due to changes in interest rates. The Asset Liability Committee (“ALCO”) is responsible for establishing policy guidelines on liquidity and acceptable exposure to interest rate risk. Generally quarterly, ALCO reports on the status of liquidity and interest rate risk matters to the Company’s board of directors. The objective of the ALCO is to manage assets and funding sources to produce results that are consistent with the Company’s liquidity, capital adequacy, growth, risk and profitability goals and are within policy limits.

The Company utilizes the pricing and structure of loans and deposits, the size and duration of the investment securities portfolio, the size and duration of the wholesale funding portfolio, and off-balance sheet interest rate contracts to manage interest rate risk. The off-balance sheet interest rate contracts may include interest rate swaps, caps and floors. These interest rate contracts involve, to varying degrees, credit risk and interest rate risk. Credit risk is the possibility that a loss may occur if a counterparty to a transaction fails to perform according to terms of the contract. The notional amount of the interest rate contracts is the amount upon which interest and other payments are based. The notional amount is not exchanged, and therefore, should not be taken as a measure of credit risk. See Note 15 to the Audited Consolidated Financial Statements for additional information.

The ALCO uses income simulation to measure interest rate risk inherent in the Company’s on-balance sheet and off-balance sheet financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over a 24-month horizon and a 60-month horizon. The simulations assume that the size and general composition of the Company’s balance sheet remain static over the simulation horizons, with the exception of certain deposit mix shifts from low-cost time deposits to higher-cost time deposits in selected interest rate scenarios. Additionally, the simulations take into account the specific repricing, maturity, call options, and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios. The characteristics of financial instrument classes are reviewed typically quarterly by the ALCO to ensure their accuracy and consistency.

The ALCO reviews simulation results to determine whether the Company’s exposure to a decline in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. As of December 31, 2021 and December 31, 2020, net interest income simulations indicated that exposure to changing interest rates over the simulation horizons remained within tolerance levels established by the Company. All changes are measured in comparison to the projected net interest income that would result from an “unchanged” rate scenario where both interest rates and the composition of the Company’s balance sheet remain stable for a 24-month and 60-month period. In addition to measuring the change in net interest income as compared to an unchanged interest rate scenario, the ALCO also measures the trend of both net interest income and net interest margin over a 24-month and 60-month horizon to ensure the stability and adequacy of this source of earnings in different interest rate scenarios.

Model results at December 31, 2021 indicated a significantly higher starting level of net interest income (“NII”) compared to the December 31, 2020 model as balance sheet growth and reductions to interest bearing liability costs during 2021 more than offset the balance sheet spread contraction of 9 basis points. As the model simulation progresses the benefit to NII increases as a result of the higher assumed replacement rates on assets resulting from the recent bond market sell-off. Our interest rate risk position continues to exhibit a benefit to rising interest rates throughout the simulations while a sustained falling rate environment presents the greatest potential exposure to earnings. This position at December 31, 2021 is slightly less asset-sensitive than the simulation at December 31, 2020 indicated.

The ALCO regularly reviews a wide variety of interest rate shift scenario results to evaluate interest rate risk exposure, including scenarios showing the effect of steepening or flattening changes in the yield curve as well as parallel changes in interest rates of up to 400 basis points. Because income simulations assume that the Company’s balance sheet will remain static over the simulation horizon, the results do not reflect adjustments in strategy that the ALCO could implement in response to rate shifts.

The FOMC maintained the federal funds target in a range of 0 to 25 basis points during 2021 due in part to economic uncertainty during the on-going pandemic. However, the FOMC’s most recent statement strongly signals that rate increases will commence in 2022 to combat inflation, and no final decision on the pace of the tightening had been made. Given the Company’s current asset/liability position, higher market interest rates may have a positive impact on our earning asset yields and variable-rate loans indexed to prime, LIBOR or other market rates.

The projected impact of instantaneous changes in interest rates on our net interest income and economic value of equity at December 31, 2021, based on our simulation model, is summarized as follows:

Changes in Interest Rates (basis points)	December 31, 2021			
	% Change in			
	Net Interest Income		Economic Value of Equity	
	Metric	Policy	Metric	Policy
+400	9.8	(20.0)	(6.3)	(40.0)
+300	7.2	(20.0)	(4.4)	(30.0)
+200	4.4	(10.0)	(2.7)	(20.0)
+100	2.0	(10.0)	0.2	(10.0)
Static				
-100	(4.1)	(10.0)	(19.3)	(10.0)

Our simulation model creates pro forma net interest income scenarios under various interest rate shocks. Given instantaneous and parallel shifts in general market rates of plus 100 basis points, our projected net interest income for the 12 months ending December 31, 2021, would increase at 2.0 percent from model results using current interest rates. The economic value of equity result in the down 100 basis point scenario is due to a negative carrying value calculated for the above market rate non-maturity deposits which distorts the metric. Additional disclosures about market risk are included in Part II, Item 7 of this Annual Report, under the heading “Market Risk Sensitivity,” and are incorporated into this Item 7A by reference.

The Company has certain loans and derivative instruments whose interest rate is indexed to the London Inter Bank Offered Rate (“LIBOR”). The LIBOR index will be discontinued for U.S. Dollar settings effective June 30, 2023. The Alternative Reference Rates Committee (“ARRC”) has proposed that the Secured Overnight Funding Rate (“SOFR”) replace USD-LIBOR. ARRC has proposed that the transition to SOFR from USD-LIBOR take place by the end of 2021. The Company has contracts that are indexed to USD-LIBOR. Industry organizations are currently working on the transition plan. The Company has formed a LIBOR transition team which is currently monitoring this activity. The Company has begun transitioning LIBOR-indexed loans to alternative indexes, including prime and Term SOFR, and adjusting the spread to maintain the overall yield.

## **Item 8. Financial Statements.**

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of  
Peoples Financial Services Corp. and Subsidiaries

#### **Opinions on the Financial Statements and Internal Control over Financial Reporting**

We have audited the accompanying consolidated balance sheets of Peoples Financial Services Corp. and Subsidiaries (Company) as of December 31, 2021 and 2020, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows, for each of the three years in the period ended December 31, 2021, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of December 31, 2021, based on criteria established in *Internal Control – Integrated Framework: (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2021, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2021, based on criteria established in *Internal Control – Integrated Framework: (2013)* issued by COSO.

#### **Basis for Opinions**

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

## **Definition and Limitations of Internal Control over Financial Reporting**

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Critical Audit Matter**

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

### **Allowance for Loan Losses – General Component Qualitative Factors**

As discussed in Notes 1 and 4 to the consolidated financial statements, the allowance for loan losses is established through a provision for loan losses and represents an amount, which, in management's judgment, will be adequate to absorb losses in the loan portfolio. The Company's allowance for loan losses was \$28.4 million at December 31, 2021 and consists of specific and general components of \$175 thousand and \$28.2 million, respectively. Management develops the general component based on historical loan loss experience adjusted for qualitative factors not reflected in the historical loss experience. Historical loss ratios are measured on a rolling twelve-quarter basis for all loans. The qualitative factors used by the Company include factors such as national and local economic conditions, levels of and trends in classified loans, delinquency rates and nonaccrual loans, trends in volumes and terms of loans, changes in lending policies, lending personnel, and collateral, as well as concentrations in loan types, industry, and geography. The adjustments for qualitative factors require a significant amount of judgment by management and involve a high degree of estimation uncertainty.

We identified the qualitative factor component of the allowance for loan losses as a critical audit matter as auditing the underlying qualitative factors required significant auditor judgment as amounts determined by management rely on analysis that is highly subjective and includes significant estimation uncertainty.

Our audit procedures related to the qualitative factor component of the allowance for loan losses included the following, among others:

- Obtaining an understanding of the relevant controls related to the allowance for loan losses and tested such controls for design and operating effectiveness, including controls related to management's establishment, review, and approval of the qualitative factors, and the completeness and accuracy of data used in determining qualitative factors.

- Evaluation of the appropriateness of management’s methodology for estimating the allowance for loan losses.
- Testing of the completeness and accuracy of data used by management in determining qualitative factor adjustments by agreeing them to internal and external source data.
- Testing of management’s conclusions regarding the appropriateness of the qualitative factor adjustments and agreement of any changes therein to the allowance for loan losses calculation.

/s/ Baker Tilly US, LLP

We have served as the Company’s auditor since 2017.

Wilkes-Barre, Pennsylvania

March 16, 2022

**Peoples Financial Services Corp.**  
**CONSOLIDATED BALANCE SHEETS**  
**(Dollars in thousands, except share data)**

December 31	2021	2020
<b>Assets:</b>		
Cash and cash equivalents		
Cash and due from banks	\$ 30,415	\$ 29,287
Interest-bearing deposits in other banks	7,093	15,905
Federal funds sold	242,425	183,000
Total cash and cash equivalents	279,933	228,192
Investment securities:		
Available-for-sale	517,321	295,911
Equity investments carried at fair value	140	138
Held-to-maturity: Fair value December 31, 2021, \$70,446; December 31, 2020, \$7,513	71,213	7,225
Total investment securities	588,674	303,274
Loans	2,329,173	2,177,982
Less: allowance for loan losses	28,383	27,344
Net loans	2,300,790	2,150,638
Loans held for sale	408	837
Premises and equipment, net	51,502	47,045
Accrued interest receivable	8,528	8,255
Goodwill	63,370	63,370
Intangible assets, net	468	960
Bank owned life insurance	42,754	42,316
Other assets	33,056	38,915
Total assets	<u>\$ 3,369,483</u>	<u>\$ 2,883,802</u>
<b>Liabilities:</b>		
Deposits:		
Noninterest-bearing	\$ 737,756	\$ 622,475
Interest-bearing	2,225,641	1,814,638
Total deposits	2,963,397	2,437,113
Short-term borrowings		50,000
Long-term debt	2,711	14,769
Subordinated debentures	33,000	33,000
Accrued interest payable	408	736
Other liabilities	29,841	31,307
Total liabilities	<u>3,029,357</u>	<u>2,566,925</u>
<b>Stockholders' equity:</b>		
Common stock, par value \$2.00, authorized 25,000,000 shares, issued and outstanding 7,169,372 shares at December 31, 2021 and 7,215,202 shares at December 31, 2020	14,341	14,431
Capital surplus	127,549	129,274
Retained earnings	203,750	171,023
Accumulated other comprehensive income (loss)	(5,514)	2,149
Total stockholders' equity	340,126	316,877
Total liabilities and stockholders' equity	<u>\$ 3,369,483</u>	<u>\$ 2,883,802</u>

See notes to consolidated financial statements.



**Peoples Financial Services Corp.**  
**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
(Dollars in thousands, except per share data)

Year Ended December 31	2021	2020	2019
<b>Interest income:</b>			
Interest and fees on loans:			
Taxable	\$ 82,493	\$ 83,683	\$ 82,488
Tax-exempt	3,957	3,736	4,309
Interest and dividends on investment securities:			
Taxable	5,464	5,334	4,435
Tax-exempt	1,731	1,178	1,878
Dividends	74	97	84
Interest on interest-bearing deposits in other banks	8	31	65
Interest on federal funds sold	330	66	122
Total interest income	<u>94,057</u>	<u>94,125</u>	<u>93,381</u>
<b>Interest expense:</b>			
Interest on deposits	7,310	11,739	14,995
Interest on short-term borrowings	78	848	1,642
Interest on long-term debt	260	702	1,231
Interest on subordinated debt	1,774	1,035	
Total interest expense	<u>9,422</u>	<u>14,324</u>	<u>17,868</u>
Net interest income	<u>84,635</u>	<u>79,801</u>	<u>75,513</u>
Provision for loan losses	1,750	7,400	6,100
Net interest income after provision for loan losses	<u>82,885</u>	<u>72,401</u>	<u>69,413</u>
<b>Noninterest income:</b>			
Service charges, fees, commissions and other	6,169	6,809	7,236
Merchant services income	879	824	973
Commission and fees on fiduciary activities	2,273	2,125	2,087
Wealth management income	1,537	1,282	1,524
Mortgage banking income	975	1,595	600
Increase in cash surrender value of life insurance	889	774	755
Interest rate swap revenue	759	2,321	1,790
Net gain (loss) on equity investment securities	2	(6)	132
Net gain on sale of investment securities available-for-sale		918	23
Gain on sale of Visa Class B shares	12,153		
Total noninterest income	<u>25,636</u>	<u>16,642</u>	<u>15,120</u>
<b>Salaries and employee benefits expense</b>			
Salaries and employee benefits expense	29,736	30,135	31,374
Net occupancy and equipment expense	12,848	12,840	11,911
Amortization of intangible assets	491	606	730
Professional fees and outside services	2,137	2,091	1,758
FDIC insurance and assessments	1,117	873	651
Donations	1,435	1,357	1,441
Other expenses	7,240	6,966	7,777
Total noninterest expense	<u>55,004</u>	<u>54,868</u>	<u>55,642</u>
Income before income taxes	53,517	34,175	28,891
Income tax expense	9,998	4,821	3,155
Net income	<u>43,519</u>	<u>29,354</u>	<u>25,736</u>
<b>Other comprehensive income (loss):</b>			
Unrealized gain (loss) on investment securities available-for-sale	(11,487)	8,779	5,109
Reclassification adjustment for net gain on sales included in net income		(918)	(23)
Change in benefit plan liabilities	2,109	(1,398)	639
Change in derivative fair value	(322)	315	441
Other comprehensive income (loss)	(9,700)	6,778	6,166
Income tax expense (benefit)	(2,037)	1,424	1,295
Other comprehensive income (loss), net of income taxes	<u>(7,663)</u>	<u>5,354</u>	<u>4,871</u>
Comprehensive income	<u>\$ 35,856</u>	<u>\$ 34,708</u>	<u>\$ 30,607</u>
<b>Per share data:</b>			
Net income:			
Basic	\$ 6.05	\$ 4.02	\$ 3.48
Diluted	\$ 6.02	\$ 4.00	\$ 3.47
Average common shares outstanding:			
Basic	7,196,160	7,304,956	7,395,429
Diluted	7,235,303	7,337,843	7,412,369
Dividends declared	\$ 1.50	\$ 1.44	\$ 1.37

See notes to consolidated financial statements

**Peoples Financial Services Corp.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**(Dollars in thousands, except per share data)**

<b>For the Three Years Ended December 31, 2021</b>	<b>Common Stock</b>	<b>Capital Surplus</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Treasury Stock</b>	<b>Total</b>
<b>Balance, January 1, 2019</b>	\$ 14,798	\$ 135,310	\$ 136,582	\$ (8,076)	\$	\$ 278,614
Net income			25,736			25,736
Other comprehensive loss, net of income taxes				4,871		4,871
Dividends declared: \$1.37 per share			(10,131)			(10,131)
Stock based compensation		554				554
Restricted stock issued: 3,854 shares, (unearned income \$147k)	8	(8)				
Share retirement: 14,428 shares	(29)	(605)				(634)
<b>Balance, December 31, 2019</b>	<u>14,777</u>	<u>135,251</u>	<u>152,187</u>	<u>(3,205)</u>		<u>299,010</u>
Net income			29,354			29,354
Other comprehensive income, net of income taxes				5,354		5,354
Dividends declared: \$1.44 per share			(10,518)			(10,518)
Stock based compensation		570				570
Restricted stock issued: 8,506 shares, (unearned income \$520k)	17	(17)				
Share retirement: 181,417 shares	(363)	(6,530)				(6,893)
<b>Balance, December 31, 2020</b>	<u>14,431</u>	<u>129,274</u>	<u>171,023</u>	<u>2,149</u>		<u>316,877</u>
Net income			43,519			43,519
Other comprehensive income, net of income taxes				(7,663)		(7,663)
Dividends declared: \$1.50 per share			(10,792)			(10,792)
Stock based compensation		546				546
Restricted stock issued: 9,192 shares, (unearned income \$182k)	18	(18)				
Share retirement: 54,285 shares	(108)	(2,253)				(2,361)
<b>Balance, December 31, 2021</b>	<u>\$ 14,341</u>	<u>\$ 127,549</u>	<u>\$ 203,750</u>	<u>\$ (5,514)</u>	<u>\$</u>	<u>\$ 340,126</u>

See notes to consolidated financial statements

**Peoples Financial Services Corp.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Dollars in thousands, except per share data)**

Year Ended December 31,	2021	2020	2019
<b>Cash flows from operating activities:</b>			
Net income	\$ 43,519	\$ 29,354	\$ 25,736
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of premises and equipment	2,702	2,900	3,083
Amortization of right-of-use lease asset	449	744	398
Accretion of deferred loan fees, net	(491)	(2,236)	(164)
Amortization of intangibles	491	606	730
Amortization of low income housing partnerships	427	569	476
Provision for loan losses	1,750	7,400	6,100
Net unrealized (gain) loss on equity investment securities	(2)	35	(132)
Gain on sale of Visa Class B shares	(12,153)		
Net (gain) loss on sale of other real estate owned	(126)	39	9
Net gain on sale of equity securities		(29)	
Loans originated for sale	(24,387)	(43,780)	(15,901)
Proceeds from sale of loans originated for sale	25,147	44,832	15,753
Net gain on sale of loans originated for sale	(331)	(903)	(89)
Net amortization of investment securities	1,317	1,084	1,668
Net gain on sale of investment securities available-for-sale		(918)	(23)
Gain on sale of premises and equipment	(50)		
Increase in cash surrender value of life insurance	(889)	(774)	(755)
Deferred income tax expense	450	(1,779)	394
Stock based compensation	546	570	554
Net change in:			
Accrued interest receivable	(273)	(1,274)	134
Other assets	1,128	(12,268)	(3,363)
Accrued interest payable	(328)	(541)	82
Other liabilities	1,875	13,549	2,389
Net cash provided by operating activities	<u>40,771</u>	<u>37,180</u>	<u>37,079</u>
<b>Cash flows from investing activities:</b>			
Proceeds from sales of investment securities available-for-sale		65,120	9,677
Proceeds from repayments of investment securities:			
Available-for-sale	57,513	84,622	57,477
Held-to-maturity	2,886	427	697
Proceeds from sale of Visa Class B shares	12,153		
Purchases of investment securities:			
Available-for-sale	(291,658)	(107,196)	(124,501)
Held-to-maturity	(66,943)		
Net redemption (purchase) of restricted equity securities	1,352	4,804	(2,739)
Net increase in loans	(151,955)	(241,307)	(119,998)
Investment in bank owned life insurance		(6,500)	
Purchases of premises and equipment	(4,885)	(2,292)	(5,603)
Proceeds from the sale of premises and equipment	58	435	
Proceeds from bank owned life insurance	451		
Proceeds from sale of other real estate owned	925	647	269
Net cash used in investing activities	<u>(440,103)</u>	<u>(201,240)</u>	<u>(184,721)</u>
<b>Cash flows from financing activities:</b>			
Net increase in deposits	526,284	465,624	96,467
Proceeds from long-term debt			16,000
Proceeds from Paycheck Protection Program Liquidity Facility		103,650	
Repayment of Paycheck Protection Program Liquidity Facility		(103,650)	
Proceeds from subordinated debentures		33,000	
Repayment of long-term debt	(12,058)	(17,964)	(21,173)
Net (decrease) increase in short-term borrowings	(50,000)	(102,150)	65,650
Retirement of common stock	(2,361)	(6,893)	(634)
Cash dividends paid	(10,792)	(10,518)	(10,131)
Net cash provided by financing activities	<u>451,073</u>	<u>361,099</u>	<u>146,179</u>
Net increase (decrease) in cash and cash equivalents	51,741	197,039	(1,463)
Cash and cash equivalents at beginning of period	228,192	31,153	32,616
Cash and cash equivalents at end of period	<u>\$ 279,933</u>	<u>\$ 228,192</u>	<u>\$ 31,153</u>

**Peoples Financial Services Corp.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Dollars in thousands, except per share data)**

Year Ended December 31,	2021	2020	2019
<b>Supplemental disclosures:</b>			
Cash paid during the period for:			
Interest	\$ 9,750	\$ 14,865	\$ 17,786
Income taxes	6,740	6,250	4,550
Noncash items:			
Transfers of loans to other real estate	\$ 544	\$ 1,163	\$ 421
Origination of mortgage servicing rights	247	318	172
Initial recognition of right-of-use assets	2,731	899	6,523
Initial recognition of lease liability	2,731	899	6,523

See notes to consolidated financial statements

**Peoples Financial Services Corp.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in thousands, except per share data)**

**1. Summary of significant accounting policies:**

**Nature of operations:**

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company (“Peoples Bank”), collectively, the “Company,” the “Parent Company,” or “Peoples.” The Company services its retail and commercial customers through twenty-eight full-service community banking offices located within Allegheny, Bucks, Lackawanna, Lebanon, Lehigh, Luzerne, Monroe, Montgomery, Northampton, Susquehanna and Wyoming Counties of Pennsylvania, Middlesex County of New Jersey and Broome County of New York.

Peoples Bank is a state-chartered bank and trust company under the jurisdiction of the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. Peoples Bank’s primary product is loans to small and medium-sized businesses. Other lending products include one-to-four family residential mortgages and consumer loans. Peoples Bank primarily funds its loans by offering deposits to commercial enterprises and individuals. Deposit product offerings include checking accounts, savings accounts, money market accounts and certificates of deposits.

The Company faces competition primarily from commercial banks, thrift institutions and credit unions within its market, many of which are larger in terms of assets and capital. In addition, mutual funds and security brokers compete for various types of deposits, and consumer, mortgage, leasing and insurance companies compete for various types of loans and leases. Principal methods of competing for banking and permitted nonbanking services include price, nature of product, quality of service and convenience of location.

Peoples Financial Services Corp. and Peoples Bank are subject to regulations of certain federal and state regulatory agencies and undergo periodic examinations.

**Basis of presentation:**

The consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”), Regulation S-X and reporting practices applied in the banking industry. All significant intercompany balances and transactions have been eliminated in consolidation. The Company also presents herein condensed parent company only financial information regarding the Parent Company. Prior period amounts are reclassified when necessary to conform with the current year’s presentation. Such reclassifications had no effect on financial position or results of operations.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2021, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

**Estimates:**

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly susceptible to material change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, the valuation of deferred tax assets, the valuation of derivative instruments, determination of other-than-temporary impairment losses on securities and impairment of goodwill. Actual results could differ from those estimates.

**Investment securities:**

Investment securities are classified and accounted for as either held-to-maturity or available-for-sale securities based on management's intent at the time of acquisition. Management is required to reassess the appropriateness of such classifications at each reporting date. The Company classifies debt securities as held-to maturity when management has the positive intent and ability to hold such securities to maturity. Held-to-maturity securities are stated at cost, adjusted for amortization of premium and accretion of discount. Investment securities are designated as available-for-sale when they are to be held for indefinite periods of time as management intends to use such securities to implement asset/liability strategies or to sell them in response to changes in interest rates, prepayment risk, liquidity requirements, or other circumstances identified by management. Available-for-sale securities are reported at fair value, with unrealized gains and losses, net of income taxes, excluded from earnings and reported in a separate component of stockholders' equity. All marketable equity securities are accounted for at fair value with unrealized gains and losses reported in earnings. Estimated fair values for investment securities are based on quoted market prices from a national pricing service. Realized gains and losses are computed using the specific identification method and are included in noninterest income. Premiums on callable debt securities are amortized to the earliest call date from the maturity date. Premiums on non-callable securities are amortized and discounts are accreted using the interest method over the expected life of the security. Investment securities that are bought and held principally for the purpose of selling them in the near term, in order to generate profits from market appreciation, are classified as trading account securities. Transfers of securities between categories are recorded at fair value at the date of the transfer, with the accounting treatment of unrealized gains or losses determined by the category into which the security is transferred.

Management evaluates each investment security to determine if a decline in fair value below its amortized cost is an other-than-temporary impairment ("OTTI") at least quarterly, and more frequently when economic or market concerns warrant an evaluation. Factors considered in determining whether an other-than-temporary impairment was incurred include: (i) the length of time and the extent to which the fair value has been less than amortized cost; (ii) the financial condition and near-term prospects of the issuer; (iii) whether a decline in fair value is attributable to adverse conditions specifically related to the security or specific conditions in an industry or geographic area; (iv) the credit-worthiness of the issuer of the security; (v) whether dividend or interest payments have been reduced or have not been made; (vi) an adverse change in the remaining expected cash flows from the security such that the Company will not recover the amortized cost of the security; (vii) whether management intends to sell the security; and (viii) if it is more likely than not that management will be required to sell the security before recovery. If a decline is judged to be other-than-temporary, the individual security is written-down to fair value with the credit related component of the write-down included in earnings. The assessment of whether an other-than-temporary impairment exists involves a high degree of subjectivity and judgment and is based on information available to management at a point in time.

**Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Loans held for sale:**

Loans held for sale consist of one-to-four family residential mortgages originated and intended for sale in the secondary market. The loans are carried in aggregate at the lower of cost or estimated market value, based upon current delivery prices in the secondary mortgage market. Net unrealized losses are recognized through a valuation allowance by corresponding charges to income. Gains or losses on the sale of these loans are recognized in noninterest income at the time of sale using the specific identification method. Loan origination fees, net of certain direct loan origination costs, are included in net gains or losses upon the sale of the related mortgage loan.

**Loans, net:**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of deferred fees or costs. Interest income is accrued on the principal amount outstanding. Loan origination fees, net of certain direct origination costs, are deferred and recognized over the contractual life of the related loan as an adjustment to yield using the effective interest method. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective interest method. Delinquency fees are recognized in income at the time when they are paid by customer.

The loan portfolio is segmented into commercial and retail loans. Commercial loans consist of commercial, commercial real estate, municipal and other related tax free loans. Retail loans consist of residential real estate and other consumer loans.

The Company makes commercial loans for real estate development and other business purposes to its customers. The Company's credit policies establish advance rates against the different forms of collateral that can be pledged against various commercial loans. Typically, the majority of loans will be underwritten to a percentage of their underlying collateral values such as real estate values, equipment, eligible accounts receivable and inventory. Individual loan advance rates may be higher or lower depending upon the financial strength of the borrower and/or term of the loan. Generally, assets financed through commercial loans are used for the operations of the business. Repayment for these types of loans generally comes from the cash flow of the business or the ongoing conversion of assets. Commercial real estate loans include construction, mini-perm, or longer term loans financing commercial properties. Repayment of these loans is generally dependent upon either the ongoing business cash flow from an owner occupied property or the lease/rental income or sale of a non-owner occupied property. Commercial real estate loans typically require a loan to value of not greater than 80% and vary in terms. In addition, the payment expectations on loans secured by income-producing properties typically depend on the successful operations of the related business and thus may be subject to a greater extent to adverse conditions in the real estate market and in the general economy.

Loans secured by commercial real estate generally have larger balances and involve a greater degree of risk than one-to-four family residential mortgage loans and consumer loans. Of primary concern in commercial real estate lending is the borrower's and any guarantor's creditworthiness and the feasibility and cash flow potential of the financed project. Additional considerations include: location, market and geographic concentration risks, loan to value, strength of guarantors and quality of tenants. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a higher level of risk than residential real estate loans, which could be caused by unfavorable conditions in the real estate market or the economy. To effectively monitor loans on income properties, the Company requires borrowers and loan guarantors, if any, to provide annual financial statements on commercial real estate loans and rent rolls where applicable. In reaching a decision on whether to make a commercial real estate loan, the Company considers and reviews a cash flow analysis of the borrower and guarantor, when applicable. In addition, the Company evaluates business cash flows, if applicable, net operating income of the property, the borrower's expertise, credit history and the value of the underlying property. The Company has generally required that the properties securing these real estate loans have debt service coverage ratios, which is net cash flow before debt service to debt service, of at least 1.2 times. An environmental report is obtained when the possibility exists that hazardous materials may have existed on the site, or the site may have been impacted by adjoining properties that handled hazardous materials.

Commercial loans are generally made on the basis of a business entity or individual borrower's ability to make repayment from business cash flows or individual borrowers' employment and other income. Commercial business loans tend to have a slightly higher risk than commercial real estate loans because collateral usually consists of business assets versus real estate. Further, any collateral securing such loans may depreciate over time and could be difficult to appraise and liquidate. As a result, repayment of commercial business loans may depend substantially on the success of the business itself.

Residential mortgages, including home equity loans, are secured by the borrower's residential real estate in either a first or second lien position. Residential mortgages have varying loan rates depending on the financial condition of the borrower, loan to value ratio and term. Residential mortgages may have amortizations up to 30 years.

Consumer loans include installment loans, car loans, and overdraft lines of credit. These loans are both secured and unsecured. Consumer loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured. Repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and a small remaining deficiency often does not warrant further substantial collection efforts against the borrower. Consumer loan collections depend on the borrower's continuing financial stability, and therefore are likely to be adversely affected by various factors, including job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state insolvency laws, may limit the amount that can be recovered on such loans.

#### **Off-balance sheet financial instruments:**

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, unused portions of lines of credit and standby letters of credit. These financial instruments are recorded in the consolidated financial statements when they are funded. Fees on commercial letters of credit and on unused available lines of credit are recorded as interest and fees on loans and are included in interest income when paid. The Company records an allowance for off-balance sheet credit losses, if deemed necessary, separately as a liability.

#### **Nonperforming assets:**

Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans include nonaccrual loans, troubled debt restructured loans and accruing loans past due 90 days or more. Past due status is based on contractual terms of the loan. Generally, a loan is classified as nonaccrual when it is determined that the collection of all or a portion of interest or principal is doubtful or when a default of interest or principal has existed for 90 days or more, unless the loan is well secured and in the process of collection. When a loan is placed on nonaccrual, interest accruals discontinue and uncollected accrued interest is reversed against income in the current period. Interest collections after a loan has been placed on nonaccrual status are credited to a suspense account until either the loan is returned to performing status or charged-off. The interest accumulated in the suspense account is credited to income over the remaining life of the loan using the effective yield method if the nonaccrual loan is returned to performing status. However, if the nonaccrual loan is charged-off, the accumulated interest is applied as a reduction to principal at the time the loan is charged-off. A nonaccrual loan is returned to performing status when the loan is current as to principal and interest and has performed according to the contractual terms for a minimum of six months.

Troubled debt restructured loans ("TDRs") are loans with original terms, interest rate, or both, that have been modified as a result of a deterioration in the borrower's financial condition and a concession has been granted that the Company would not otherwise consider. Unless on nonaccrual, interest income on these loans is recognized when earned, using the interest method. The Company offers a variety of modifications to borrowers that would be considered concessions. The modification categories offered can generally fall within the following categories:

- Rate Modification — A modification in which the interest rate is changed to a below market rate.
- Term Modification — A modification in which the maturity date, timing of payments or frequency of payments is changed.
- Interest Only Modification — A modification in which the loan is converted to interest only payments for a period of time.
- Payment Modification — A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.



- Combination Modification — Any other type of modification, including the use of multiple categories above.

The Company segments loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Loans are individually analyzed for credit risk by classifying them within the Company's internal risk rating system. The Company's risk rating classifications are defined as follows:

- Pass — A loan to borrowers with acceptable credit quality and risk that is not adversely classified as Substandard, Doubtful, Loss nor designated as Special Mention.
- Special Mention — A loan that has potential weaknesses that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special Mention loans are not adversely classified since they do not expose the Company to sufficient risk to warrant adverse classification.
- Substandard — A loan that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.
- Doubtful — A loan classified as Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.
- Loss — A loan classified as Loss is considered uncollectible and of such little value that its continuance as a bankable loan is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future.

Other real estate owned is comprised of properties acquired through foreclosure proceedings or in-substance foreclosures. A loan is classified as in-substance foreclosure when the Company has taken possession of the collateral regardless of whether formal foreclosure proceedings take place. Other real estate owned is included in other assets and recorded at fair value less cost to sell at the time of acquisition, establishing a new cost basis. Any excess of the loan balance over the recorded value is charged to the allowance for loan losses. Subsequent declines in the recorded values of the properties prior to their disposal and costs to maintain the assets are included in other expenses. Any gain or loss realized upon disposal of other real estate owned is included in noninterest expense.

#### **Allowance for loan losses:**

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date. The allowance for loan losses account is maintained through a provision for loan losses charged to earnings. Loans, or portions of loans, determined to be confirmed losses are charged against the allowance account and subsequent recoveries, if any, are credited to the account. A loss is considered confirmed when information available at the financial statement date indicates the loan, or a portion thereof, is uncollectible. Nonaccrual, troubled debt restructured and loans deemed impaired at the time of acquisition are reviewed monthly to determine if carrying value reductions are warranted or if these classifications should be changed. Consumer loans are considered losses and charged-off when they are 120 days past due.

Management evaluates the adequacy of the allowance for loan losses account quarterly. This assessment is based on past charge-off experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to

significant revision as more information becomes available. Regulators, in reviewing the loan portfolio as part of the scope of a regulatory examination, may require the Company to increase its allowance for loan losses or take other actions that would require the Company to increase its allowance for loan losses.

The allowance for loan losses is maintained at a level believed to be adequate to absorb probable credit losses related to specifically identified loans, as well as probable incurred losses inherent in the remainder of the loan portfolio as of the balance sheet date. The allowance for loan losses consists of an allocated element and an unallocated element. The allocated element consists of a specific allowance for impaired loans individually evaluated and a formula portion for loss contingencies on those loans collectively evaluated.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Factors considered by management in determining impairment include payment status, ability to pay 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. Management determines 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. The Company recognizes interest income on impaired loans, including the recording of cash receipts, for nonaccrual, restructured loans or accruing loans depending on the status of the impaired loan. Loans considered impaired are measured for impairment based on 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. If 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, is less than the recorded investment in the loan, a specific allowance for the loan will be established.

The formula portion of the allowance for loan losses relates to large pools of smaller-balance homogeneous loans and those identified loans considered not individually impaired having similar characteristics as these loan pools. Loss contingencies for each of the major loan pools are determined by applying a total loss factor to the current balance outstanding for each individual pool. The total loss factor is comprised of a historical loss factor using a loss migration method plus qualitative factors, which adjusts the historical loss factor for changes in trends, conditions and other relevant factors that may affect repayment of the loans in these pools as of the evaluation date. Loss migration involves determining the percentage of each pool that is expected to ultimately result in loss based on historical loss experience. The historical loss factor for each pool is a weighted average of the Company's historical net charge-off ratio for the most recent rolling twelve quarters. Management adjusts these historical loss factors by qualitative factors that represents a number of environmental risks that may cause estimated credit losses associated with the current portfolio to differ from historical loss experience. These environmental risks include: (i) changes in lending policies and procedures including underwriting standards and collection, charge-off and recovery practices; (ii) changes in the composition and volume of the portfolio; (iii) changes in national, local and industry conditions, including the effects of such changes on the value of underlying collateral for collateral-dependent loans; (iv) changes in the volume and severity of classified loans, including past due, nonaccrual, troubled debt restructures and other loan modifications; (v) changes in the levels of, and trends in, charge-offs and recoveries; (vi) the existence and effect of any concentrations of credit and changes in the level of such concentrations; (vii) changes in the experience, ability and depth of lending management and other relevant staff; (viii) changes in the quality of the loan review system and the degree of oversight by the board of directors; and (ix) the effect of external factors such as competition, pandemics and legal and regulatory requirements on the level of estimated credit losses in the current loan portfolio. Each environmental risk factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

Management believes the level of the allowance for loan losses was adequate to absorb probable credit losses inherent in the loan portfolio as of December 31, 2021.

### **Revenue from Contracts with Customers:**

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the consolidated statements of income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. The following is a discussion of revenues within the scope of the guidance:

- *Service charges, fees, commissions and other.* Service charges, fees and commissions on deposit accounts include fees for banking services provided, overdrafts and non-sufficient funds. Revenue is generally recognized in accordance with published deposit account agreements for retail accounts or contractual agreements for commercial accounts. The Company's deposit services also include our ATM and debit card interchange revenue that is presented gross of the associated costs. Interchange revenue is generated by the Company's deposit customers' usage and volume of activity. Interchange rates are not controlled by the Company, which effectively acts as processor that collects and remits payments associated with customer debit card transactions.
- *Commission and fees on fiduciary activities.* Commission and fees on fiduciary activities includes fees and commissions from investment management, administrative and advisory services primarily for individuals, and to a lesser extent, partnerships and corporations. Revenue is recognized on an accrual basis at the time the services are performed and when the Company has a right to invoice and are based on either the market value of the assets managed or the services provided.
- *Wealth management income.* Wealth management income includes fees and commissions charged when the Company arranges for another party to transfer brokerage services to a customer. The fees and commissions under this agent relationship are based upon stated fee schedules based upon the type of transaction, volume, and value of the services provided.
- *Merchant services income.* Merchant services revenue is derived from a third party vendor that processes credit card transactions on behalf of the Company's merchant customers. Merchant services revenue is primarily comprised of residual fee income based on the referred merchant's processing volumes and/or margin.

### **Premises, equipment and lease commitments:**

Land is stated at cost. Premises, equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization. The cost of routine maintenance and repairs is expensed as incurred. The cost of major replacements, renewals and betterments is capitalized. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation and amortization are eliminated and any resulting gain or loss is reflected in noninterest income. Depreciation and amortization are computed principally using the straight-line method based on the following

estimated useful lives of the related assets, or in the case of leasehold improvements, to the expected terms of the leases, if shorter:

Premises and leasehold improvements	7 – 40 years
Furniture, fixtures and equipment	3 – 10 years

A right-of-use asset and related lease liability is recognized on the Consolidated Statements of Financial Condition for operating leases Peoples Bank has entered to lease certain office facilities. These amounts are reported as components of premises and equipment and other liabilities. Short-term operating leases, which are leases with an original term of 12 months or less and do not have a purchase option that is likely to be exercised, are not recognized as part of the right-of-use asset or lease liability.

#### **Goodwill and other intangible assets, net:**

The Company accounts for its acquisitions using the purchase accounting method. Purchase accounting requires the total purchase price to be allocated to the estimated fair values of assets acquired and liabilities assumed, including certain intangible assets that must be recognized. Typically, this allocation results in the purchase price exceeding the fair value of net assets acquired, which is recorded as goodwill. Core deposit intangibles are a measure of the value of checking, money market and savings deposits acquired in business combinations. Core deposit intangibles and other identified intangibles with finite useful lives are amortized using the sum of the year's digits over their estimated useful lives of up to ten years.

Goodwill and other intangible assets are tested for impairment annually or when circumstances arise indicating impairment may have occurred. In making this assessment that impairment may have occurred, management considers a number of factors including, but not limited to, operating results, business plans, economic projections, anticipated future cash flows, and current market data. There are inherent uncertainties related to these factors and management's judgment in applying them to the analysis of impairment. Changes in economic and operating conditions, as well as other factors, could result in impairment in future periods. Any impairment losses arising from such testing would be reported in the consolidated statements of income and comprehensive income as a separate line item within operations. There were no impairment losses recognized as a result of periodic impairment testing in each of the three-years ended December 31, 2021.

#### **Mortgage servicing rights:**

Mortgage servicing rights are recognized as a separate asset upon the sale and servicing of mortgage loans by the Company. The Company calculates a mortgage servicing right by allocating the total costs incurred between the loan sold and the servicing right, based on their relative fair values at the date of the sale. Mortgage servicing rights are included in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying mortgage loans. In addition, mortgage servicing rights are evaluated for impairment at each reporting date based on the fair value of those rights. For purposes of measuring impairment, the rights are stratified by loan type, term and interest rate. The amount of impairment recognized, through a valuation allowance, is the amount by which the mortgage servicing rights for a stratum exceed their fair value.

#### **Restricted equity securities:**

As a member of the Federal Home Loan Bank of Pittsburgh ("FHLB"), the Company is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be redeemed by the FHLB or transferred to another member institution, and all redemptions of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants. The carrying value of restricted stock is included in other assets.

**Bank owned life insurance:**

The Company invests in bank owned life insurance (“BOLI”) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance on certain employees or directors. The Company is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from increases in cash surrender value of the policies is included in noninterest income. The policies can be liquidated, if necessary, with associated tax costs. However, the Company intends to hold these policies and, accordingly, the Company has not provided for income taxes on the earnings from the increase in cash surrender value.

**Pension and post-retirement benefit plans:**

The Company sponsors a separate Employee Stock Ownership Plan (“ESOP”) and Retirement Profit Sharing 401(k) Plan and maintains Supplemental Executive Retirement Plans (“SERPs”) and an employee pension plan, which is currently frozen. The Company also provides post-retirement benefit plans other than pensions, consisting principally of life insurance benefits, to eligible retirees. The liabilities and annual income or expense of the Company’s pension and other post-retirement benefit plans are determined using methodologies that involve several actuarial assumptions, the most significant of which are the discount rate and the long-term rate of asset return, based on the market-related value of assets. The fair values of plan assets are determined based on prevailing market prices or estimated fair value for investments with no available quoted prices.

**Statements of Cash Flows:**

Cash and cash equivalents include cash on hand, cash items in the process of collection, noninterest-bearing and interest-bearing deposits in other banks and federal funds sold.

**Derivative Instruments and Hedging Activities:**

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

The Company has elected to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

**Fair value of financial instruments:**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosure under GAAP. Fair value estimates are calculated without attempting to estimate the value of anticipated future business and the value of certain assets and liabilities that are not considered financial. Accordingly, such assets and liabilities are excluded from disclosure requirements.

Fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. 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. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets. In many cases, these values cannot be realized in immediate settlement of the instrument.

Current fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction that is not a forced liquidation or distressed sale between participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with GAAP, the Company groups its assets and liabilities generally measured at fair value into three levels based on market information or other fair value estimates in which the assets and liabilities are traded or valued and the reliability of the assumptions used to determine fair value. These levels include:

- Level 1: Unadjusted quoted prices of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other 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.
- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following methods and assumptions were used by the Company to construct the summary table in Note 14 containing the fair values and related carrying amounts of financial instruments measured at fair value:

**Investment securities:** The fair values of marketable equity securities are based on quoted market prices from active exchange markets. The fair values of debt securities are based on pricing from a matrix pricing model and quoted market prices.

**Impaired loans:** Fair values for impaired loans are estimated using discounted cash flow analysis determined by the loan review function or underlying collateral values, where applicable.

**Interest rate swaps and floors:** Values of these instruments are obtained through an independent pricing source utilizing information which may include market observed quotations for swaps, Libor rates, forward rates and rate volatility. Derivative contracts create exposure to interest rate movements as well as risks from the potential of non-performance of the counterparty.

#### **Advertising:**

The Company follows the policy of charging marketing and advertising costs to expense as incurred. Advertising expense for the years ended December 31, 2021, 2020 and 2019 was \$575, \$462 and \$873, respectively.

#### **Income taxes:**

Deferred income taxes are provided on the balance sheet method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some

portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the effective date. A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that has a likelihood of being realized on examination of more than 50 percent. For tax positions not meeting the more likely than not threshold, no tax benefit is recorded. Under the more likely than not threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. The Company had no material unrecognized tax benefits or accrued interest and penalties for any year in the three-year period ended December 31, 2021.

As applicable, the Company recognizes accrued interest and penalties assessed as a result of a taxing authority examination through income tax expense. The Company files consolidated income tax returns in the United States of America and various state jurisdictions. With limited exception, the Company is no longer subject to federal and state income tax examinations by taxing authorities for years before 2018.

#### **Other comprehensive income (loss):**

The components of other comprehensive income (loss) and their related tax effects are reported in the consolidated statements of income and comprehensive income. The accumulated other comprehensive income (loss) included in the consolidated balance sheets relates to net unrealized gains and losses on investment securities available-for-sale, the net change in derivative fair value and the unfunded benefit plan amounts which include prior service costs and unrealized net losses.

#### **Earnings per share:**

Basic earnings per share represent income available to common stockholders 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 common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to awards of restricted stock units, and are determined using the treasury stock method.

For the Year Ended December 31,	2021		2020		2019	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
Net income	\$ 43,519	\$ 43,519	\$ 29,354	\$ 29,354	\$ 25,736	\$ 25,736
Average common shares outstanding	7,196,160	7,235,303	7,304,956	7,337,843	7,395,429	7,412,369
Earnings per share	\$ 6.05	\$ 6.02	\$ 4.02	\$ 4.00	\$ 3.48	\$ 3.47

#### **Stock-based compensation:**

The Company recognizes all share-based payments to employees in the consolidated statements of income and comprehensive income based on their fair values. The fair value of such equity instruments is recognized as an expense in the consolidated financial statements as services are performed. The Company has granted restricted stock awards and units to employees at a price equal to the fair value of the shares underlying the awards at the date of grant. The fair value of restricted stock awards and units are equivalent to the fair value on the date of grant and is amortized over the vesting period.

## **Recent accounting standards:**

### **Recently Issued But Not Yet Effective Accounting Pronouncements**

ASU 2016-13, Financial Instruments-Credit Losses (Topic 326), as modified by subsequent ASUs, changes accounting for credit losses on loans receivable and debt securities from an incurred loss methodology to an expected credit loss methodology. Among other things, ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Accordingly, ASU 2016-13 requires the use of forward-looking information to form credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, though the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, ASU 2016-13 amends the accounting for credit losses on debt securities and purchased financial assets with credit deterioration. The effect of implementing this ASU is recorded through a cumulative-effect adjustment to retained earnings. The Company has formed a committee and engaged outside vendors to implement a platform to utilize the alternative loss estimation methodologies in determining the impact that adoption of this standard will have on the Company's financial condition and results of operations. The Company is required to adopt this guidance effective January 1, 2023.

ASU 2020-04, Reference Rate Reform (Topic 848) provides temporary optional guidance to ease the potential burden in accounting for reference rate reform. The amendments in Update 2020-04 are elective and apply to all entities that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued. The guidance includes a general principle that permits an entity to consider contract modifications due to reference rate reform to be an event that does not require contract remeasurement at the modification date or reassessment of a previous accounting determination. Some specific optional expedients are as follows:

- Simplifies accounting for contract modifications, including modifications to loans receivable and debt, by prospectively adjusting the effective interest rate.
- Simplifies the assessment of hedge effectiveness and allows hedging relationships affected by reference rate reform to continue.

The amendments in ASU 2020-04 are effective as of March 12, 2020 through December 31, 2022. The Company expects to apply the amendments prospectively for applicable loan and other contracts within the effective period of ASU 2020-04.

## **2. Cash and due from banks:**

On March 26, 2020, the Board of Governors of the Federal Reserve System eliminated the reserve requirement for all depository institutions. Prior to this date, the Company was required to maintain average reserve balances as established by the Federal Reserve Bank. Total cash and due from banks balances were \$279.9 million and \$228.2 million at December 31, 2021 and 2020, respectively.



### 3. Investment securities:

The amortized cost and fair value of investment securities aggregated by investment category at December 31, 2021 and 2020 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2021</b>				
Available-for-sale:				
U.S. Treasury securities	\$ 193,849	\$ 107	\$ 2,382	\$ 191,574
U.S. government-sponsored enterprises	33,435	343		33,778
State and municipals:				
Taxable	69,066	994	1,082	68,978
Tax-exempt	96,412	2,452	614	98,250
Residential mortgage-backed securities:				
U.S. government agencies	1,790	53		1,843
U.S. government-sponsored enterprises	109,018	939	2,925	107,032
Commercial mortgage-backed securities:				
U.S. government-sponsored enterprises	12,542	406		12,948
Corporate debt securities	3,000		82	2,918
Total	<u>\$ 519,112</u>	<u>\$ 5,294</u>	<u>\$ 7,085</u>	<u>\$ 517,321</u>
Held-to-maturity:				
Tax-exempt state and municipals	\$ 11,476	\$ 126	\$ 56	\$ 11,546
Residential mortgage-backed securities:				
U.S. government agencies	18,802		392	18,410
U.S. government-sponsored enterprises	40,935	3	448	40,490
Total	<u>\$ 71,213</u>	<u>\$ 129</u>	<u>\$ 896</u>	<u>\$ 70,446</u>
<b>December 31, 2020</b>				
Available-for-sale:				
U.S. Treasury securities	\$ 18,478	\$ 427		\$ 18,905
U.S. government-sponsored enterprises	63,834	1,354		65,188
State and municipals:				
Taxable	53,297	2,099	\$ 30	55,366
Tax-exempt	53,977	3,054	37	56,994
Residential mortgage-backed securities:				
U.S. government agencies	3,553	154		3,707
U.S. government-sponsored enterprises	79,457	1,930	136	81,251
Commercial mortgage-backed securities:				
U.S. government-sponsored enterprises	12,619	881		13,500
Corporate debt securities	1,000			1,000
Total	<u>\$ 286,215</u>	<u>\$ 9,899</u>	<u>\$ 203</u>	<u>\$ 295,911</u>
Held-to-maturity:				
Tax-exempt state and municipals	\$ 6,849	\$ 275	\$	\$ 7,124
Residential mortgage-backed securities:				
U.S. government agencies	21			21
U.S. government-sponsored enterprises	355	13		368
Total	<u>\$ 7,225</u>	<u>\$ 288</u>	<u>\$</u>	<u>\$ 7,513</u>

The Company had net unrealized losses on available-for-sale securities of \$1,415, net of deferred income taxes of \$376 at December 31, 2021, and net unrealized gains on available-for-sale securities of \$7,660 net of deferred income taxes of

\$2,036, at December 31, 2020. During 2020, the Company sold a pool of low-yielding short-term municipal bonds and two mortgage-backed securities and received proceeds totaling \$64,841. Gross gains of \$923 and gross losses of \$5 were realized on the sale of investment securities in 2020. There were no sales of securities during 2021. The total securities portfolio grew in 2021 from utilizing a portion of low-yielding excess liquidity to purchase higher yielding bonds.

At December 31, 2021, our marketable equity security portfolio consisted of stock of one financial institution. During 2020, the Company sold its entire stock position in one other equity holding and received proceeds of \$279 and recognized a gain of \$29. At December 31, 2021 and December 31, 2020, we had \$140 thousand and \$138 thousand, respectively, in equity securities recorded at fair value. At December 31, 2021, the fair value of our equity portfolio was less than the cost basis by \$13 thousand. The following is a summary of unrealized and realized gains and losses recognized in net income on equity marketable securities during 2021 and 2020.

<b>Year Ended December 31,</b>	<b>2021</b>	<b>2020</b>
Net gain (loss) recognized during the period on equity securities	\$ 2	\$ (6)
Less: Net gain (loss) recognized during the period on equity securities sold during the period		29
Unrealized gain (loss) recognized during the reporting period on equity securities still held at the reporting date	<u>\$ 2</u>	<u>\$ (35)</u>

The maturity distribution of the fair value, which is the net carrying amount, of the debt securities classified as available-for-sale at December 31, 2021, is summarized as follows:

<b>December 31, 2021</b>	<b>Fair Value</b>
Within one year	\$ 28,887
After one but within five years	148,212
After five but within ten years	103,012
After ten years	112,347
	<u>392,458</u>
Mortgage-backed and other amortizing securities	124,863
Total	<u>\$ 517,321</u>

Expected maturities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at December 31, 2021, is summarized as follows:

<b>December 31, 2021</b>	<b>Amortized Cost</b>	<b>Fair Value</b>
After five but within ten years	\$ 7,331	\$ 7,334
After ten years	4,145	4,212
	11,476	11,546
Mortgage-backed securities	59,737	58,900
Total	<u>\$ 71,213</u>	<u>\$ 70,446</u>

Securities with a carrying value of \$203,580 and \$165,982 at December 31, 2021 and 2020, respectively, were pledged to secure public deposits and certain other deposits as required or permitted by law.

Securities and short-term investment activities are conducted with a diverse group of government entities, corporations and state and local municipalities. The counterparty's creditworthiness and type of collateral is evaluated on a case-by-case basis. At December 31, 2021 and 2020, there were no significant concentrations of credit risk from any one issuer, with the exception of U.S. government agencies and sponsored enterprises that exceeded 10.0 percent of stockholders' equity.

The fair value and gross unrealized losses of investment securities with unrealized losses for which an OTTI has not been recognized at December 31, 2021 and 2020, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, are summarized as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2021</b>						
U.S. Treasury securities	\$ 179,974	\$ 2,382			\$ 179,974	\$ 2,382
State and municipals:						
Taxable	26,827	718	\$ 8,008	\$ 364	34,835	1,082
Tax-exempt	38,693	357	10,319	313	49,012	670
Residential mortgage-backed securities:						
U.S. government agencies	18,398	392			18,398	392
U.S. government-sponsored enterprises	77,875	1,454	48,276	1,919	126,151	3,373
Corporate debt securities	2,449	51	470	31	2,919	82
Total	<u>\$ 344,216</u>	<u>\$ 5,354</u>	<u>\$ 67,073</u>	<u>\$ 2,627</u>	<u>\$ 411,289</u>	<u>\$ 7,981</u>
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2020</b>						
State and municipals:						
Taxable	\$ 9,246	\$ 30			\$ 9,246	\$ 30
Tax-exempt	6,786	37			6,786	37
Residential mortgage-backed securities:						
U.S. government-sponsored enterprises	11,553	135	\$ 284	\$ 1	11,837	136
Total	<u>\$ 27,585</u>	<u>\$ 202</u>	<u>\$ 284</u>	<u>\$ 1</u>	<u>\$ 27,869</u>	<u>\$ 203</u>

The Company had 168 investment securities, consisting of 63 tax-exempt and 35 taxable state and municipal obligations, 42 U.S. Treasury bonds, 5 corporate bonds and 23 mortgage-backed securities that were in unrealized loss positions at December 31, 2021. Of these securities, seven mortgage-backed securities, one corporate bond, eight taxable municipals and eighteen tax-exempt municipals, were in a continuous unrealized loss position for twelve months or more. The increase in the number and balance of bonds in an unrealized position is due to recent increase in market rates. Management does not consider the unrealized losses on the debt securities, as a result of changes in interest rates, to be OTTI based on historical evidence that indicates the cost of these securities is recoverable within a reasonable period of time in relation to normal cyclical changes in the market rates of interest. Moreover, because there has been no material change in the credit quality of the issuers or other events or circumstances that may cause a significant adverse impact on the fair value of these securities, and management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be maturity, the Company does not consider the unrealized losses to be OTTI at December 31, 2021.

There was no OTTI recognized for each of the years in the three-year period ended December 31, 2021.

On October 8, 2021, Peoples Bank sold its remaining 44,982 shares of Class B common stock of Visa Inc. for \$12.2 million. The Bank received 73,333 Class B shares of Visa Inc. as part of its membership interest in March 2008, and 28,351 shares were redeemed in connection with Visa's initial public offering in 2008. The stock had no historical cost basis and was not considered to have a readily determinable value due to restrictions on the ability to sell.

#### 4. Loans, net and allowance for loan losses:

The major classifications of loans outstanding, net of deferred loan origination fees and costs at December 31, 2021 and 2020 are summarized as follows. Net deferred loan fees of \$1,567 and \$2,058 are included in loan balances at December 31, 2021 and 2020, respectively. The decrease in deferred loan fees is due in part to PPP forgiveness during 2021. Net deferred loan origination fees remaining related to PPP loans is \$1,659 at December 31, 2021. Included in the commercial balances at December 31, 2021 are PPP loans that had an outstanding balance at December 31, 2021 of \$68,893 comprised of \$55,252 remaining from those originated during 2021 as part of round two and \$13,641 remaining from loans originated during 2020 under round one of the program. The PPP loans are risk rated 'Pass' and do not carry an allowance for loan losses due to a 100% SBA guarantee. The outstanding balance is considered current at December 31, 2021.

<u>December 31</u>	<u>2021</u>	<u>2020</u>
Commercial	\$ 613,127	\$ 679,286
Real estate:		
Commercial	1,343,539	1,137,990
Residential	297,624	277,414
Consumer	74,883	83,292
Total	<u>\$ 2,329,173</u>	<u>\$ 2,177,982</u>

Loans outstanding to directors, executive officers, principal stockholders or to their affiliates totaled \$3,173 and \$5,031 at December 31, 2021 and 2020, respectively. The decrease in loans outstanding is due to loan balances related to one former director who retired in 2021. Advances and repayments and other changes during 2021 totaled \$4,824 and \$6,682, respectively, and during 2020 totaled \$3,747 and \$5,574, respectively. There were no related party loans that were classified as nonaccrual, past due, or restructured at December 31, 2021 and 2020.

Deposits from related parties amounted to \$10.9 million at December 31, 2021 and \$9.0 million at December 31, 2020.

At December 31, 2021, the majority of the Company's loans were at least partially secured by real estate in the markets we operate in. Therefore, a primary concentration of credit risk is directly related to the real estate market in these regions. Changes in the general economy, local economy or in the real estate market could affect the ultimate collectability of this portion of the loan portfolio. Management does not believe there are any other significant concentrations of credit risk that could affect the loan portfolio.

The changes in the allowance for loan losses account by major classification of loan for the year ended December 31, 2021, 2020, and 2019 were as follows:

<b>December 31, 2021</b>	<b>Commercial</b>	<b>Real estate</b>		<b>Consumer</b>	<b>Total</b>
		<b>Commercial</b>	<b>Residential</b>		
<b>Allowance for loan losses:</b>					
Beginning balance	\$ 8,734	\$ 14,559	\$ 3,129	\$ 922	\$ 27,344
Charge-offs	(492)	(252)	(24)	(188)	(956)
Recoveries	89	68	7	81	245
Provisions (credits)	122	1,553	97	(22)	1,750
Ending balance	\$ 8,453	\$ 15,928	\$ 3,209	\$ 793	\$ 28,383
Ending balance: individually evaluated for impairment	40	109	26		175
Ending balance: collectively evaluated for impairment	\$ 8,413	\$ 15,819	\$ 3,183	\$ 793	\$ 28,208
<b>Loans receivable:</b>					
Ending balance	\$ 613,127	\$ 1,343,539	\$ 297,624	\$ 74,883	\$ 2,329,173
Ending balance: individually evaluated for impairment	199	2,890	1,273		4,362
Ending balance: collectively evaluated for impairment	\$ 612,928	\$ 1,340,649	\$ 296,351	\$ 74,883	\$ 2,324,811

The allowance for loan losses increased \$1.1 million to \$28.4 million at December 31, 2021, from \$27.3 million at the end of 2020. The increase resulted from a provision for loan losses of \$1.8 million less net loans charged-off of \$0.7 million. The allowance for loan losses at December 31, 2021 continued to reflect the provisions added during 2020 from our adjustment of qualitative factors in our allowance for loan losses methodology, due to economic decline and expectation of increased credit losses from COVID-19's adverse impact on economic and business operating conditions. The decrease to charge-offs in 2021 is due to improved credit quality. The 2021 period includes the total charge-off of a fully allocated small-business line of credit originated in our Greater Delaware Valley market totaling \$0.4 million. During 2020, \$0.9 million was charged-off related to small-business lines of credit originated in our Greater Delaware Valley market offset by \$0.2 million of recoveries.

<b>December 31, 2020</b>	<b>Commercial</b>	<b>Real estate</b>		<b>Consumer</b>	<b>Total</b>
		<b>Commercial</b>	<b>Residential</b>		
<b>Allowance for loan losses:</b>					
Beginning balance	\$ 6,888	\$ 11,496	\$ 3,226	\$ 1,067	\$ 22,677
Charge-offs	(2,771)	(144)	(247)	(317)	(3,479)
Recoveries	525	16	57	148	746
Provisions	4,092	3,191	93	24	7,400
Ending balance	\$ 8,734	\$ 14,559	\$ 3,129	\$ 922	\$ 27,344
Ending balance: individually evaluated for impairment	947	180	75		1,202
Ending balance: collectively evaluated for impairment	\$ 7,787	\$ 14,379	\$ 3,054	\$ 922	\$ 26,142
<b>Loans receivable:</b>					
Ending balance	\$ 679,286	\$ 1,137,990	\$ 277,414	\$ 83,292	\$ 2,177,982
Ending balance: individually evaluated for impairment	4,297	3,952	1,546		9,795
Ending balance: collectively evaluated for impairment	\$ 674,989	\$ 1,134,038	\$ 275,868	\$ 83,292	\$ 2,168,187

December 31, 2019	Commercial	Real estate		Consumer	Total
		Commercial	Residential		
Allowance for loan losses:					
Beginning balance	\$ 5,516	\$ 10,736	\$ 3,892	\$ 1,235	\$ 21,379
Charge-offs	(3,314)	(817)	(477)	(459)	(5,067)
Recoveries	69	1	29	166	265
Provisions (credit)	4,617	1,576	(218)	125	6,100
Ending balance	<u>\$ 6,888</u>	<u>\$ 11,496</u>	<u>\$ 3,226</u>	<u>\$ 1,067</u>	<u>\$ 22,677</u>
Ending balance: individually evaluated for impairment	363	279	135		777
Ending balance: collectively evaluated for impairment	<u>\$ 6,525</u>	<u>\$ 11,217</u>	<u>\$ 3,091</u>	<u>\$ 1,067</u>	<u>\$ 21,900</u>
Loans receivable:					
Ending balance	<u>\$ 522,957</u>	<u>\$ 1,011,423</u>	<u>\$ 301,378</u>	<u>\$ 102,482</u>	<u>\$ 1,938,240</u>
Ending balance: individually evaluated for impairment	4,658	3,048	2,153		9,859
Ending balance: collectively evaluated for impairment	<u>\$ 518,299</u>	<u>\$ 1,008,375</u>	<u>\$ 299,225</u>	<u>\$ 102,482</u>	<u>\$ 1,928,381</u>

The following tables present the major classification of loans summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system at December 31, 2021 and 2020:

December 31, 2021	Pass	Special Mention	Substandard	Doubtful	Total
Real estate:					
Commercial	1,324,646	13,939	4,954		1,343,539
Residential	294,892	333	2,399		297,624
Consumer	74,744		139		74,883
Total	<u>\$ 2,305,433</u>	<u>\$ 15,168</u>	<u>\$ 8,572</u>	<u>\$</u>	<u>\$ 2,329,173</u>

December 31, 2020	Pass	Special Mention	Substandard	Doubtful	Total
Real estate:					
Commercial	1,107,699	17,517	12,774		1,137,990
Residential	274,327	144	2,943		277,414
Consumer	83,215		77		83,292
Total	<u>\$ 2,125,800</u>	<u>\$ 31,966</u>	<u>\$ 20,216</u>	<u>\$</u>	<u>\$ 2,177,982</u>

The decrease to special mention commercial loans from December 31, 2020 to December 31, 2021 is due primarily to a payoff of a \$12.9 million municipal related credit. The decrease in special mention commercial real estate loans resulted primarily from an upgrade to a \$5.3 million credit due to a credit enhancement and satisfactory repayment history. The decrease to substandard commercial loans resulted primarily from a \$1.5 million relationship that was paid off during 2021. The decrease in substandard commercial real estate loans resulted from a refinance of a credit related to the hospitality industry that is secured by a seventy-five percent SBA guarantee.

Information concerning nonaccrual loans by major loan classification at December 31, 2021 and 2020 is summarized as follows:

	<u>December 31, 2021</u>	<u>December 31, 2020</u>
Commercial	\$ 185	\$ 3,822
Real estate:		
Commercial	1,793	3,262
Residential	694	922
Consumer	139	111
Total	<u>\$ 2,811</u>	<u>\$ 8,117</u>

The major classification of loans by past due status at December 31, 2021 and 2020 are summarized as follows:

<u>December 31, 2021</u>	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Loans &gt; 90 Days and Accruing</u>
Commercial	\$ 101	\$ 155	\$ 158	\$ 414	\$ 612,713	\$ 613,127	
Real estate:							
Commercial	768	423	834	2,025	1,341,514	1,343,539	
Residential	1,552	207	265	2,024	295,600	297,624	\$ 13
Consumer	477	163	51	691	74,192	74,883	
Total	<u>\$ 2,898</u>	<u>\$ 948</u>	<u>\$ 1,308</u>	<u>\$ 5,154</u>	<u>\$ 2,324,019</u>	<u>\$ 2,329,173</u>	<u>\$ 13</u>

<u>December 31, 2020</u>	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Loans &gt; 90 Days and Accruing</u>
Commercial	\$ 73		\$ 2,245	\$ 2,318	\$ 676,968	\$ 679,286	
Real estate:							
Commercial	414	\$ 222	2,362	2,998	1,134,992	1,137,990	
Residential	2,072	480	732	3,284	274,130	277,414	\$ 71
Consumer	384	70	67	521	82,771	83,292	
Total	<u>\$ 2,943</u>	<u>\$ 772</u>	<u>\$ 5,406</u>	<u>\$ 9,121</u>	<u>\$ 2,168,861</u>	<u>\$ 2,177,982</u>	<u>\$ 71</u>

The decrease to non-accrual loans from December 31, 2020 was due primarily to a \$1.5 million payoff and \$1.0 million payoff of two unrelated commercial relationships, a \$0.4 million total charge-off of a small business line of credit, a \$0.5 million commercial real estate loan transferred to other real estate owned, and a \$0.5 restaurant related commercial real estate loan placed back on accrual due to satisfactory repayment and improved operations.

The amount of residential loans in the formal process of foreclosure totaled \$285 at December 31, 2021 and \$135 at December 31, 2020.

The following tables summarize information concerning impaired loans as of and for the years ended December 31, 2021, 2020 and 2019 by major loan classification:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the Year Ended	
				Average Recorded Investment	Interest Income Recognized
<b>December 31, 2021</b>					
With no related allowance:					
Commercial	\$ 158	\$ 481		\$ 964	\$ 13
Real estate:					
Commercial	2,376	3,120		2,719	22
Residential	873	1,073		1,016	19
Consumer	139	148		100	
Total	<u>3,546</u>	<u>4,822</u>		<u>4,799</u>	<u>54</u>
With an allowance recorded:					
Commercial	41	41	\$ 40	1,091	15
Real estate:					
Commercial	513	543	109	802	22
Residential	401	401	26	436	13
Consumer					
Total	<u>955</u>	<u>985</u>	<u>175</u>	<u>2,329</u>	<u>50</u>
Total impaired loans					
Commercial	199	522	40	2,055	28
Real estate:					
Commercial	2,889	3,663	109	3,521	44
Residential	1,274	1,474	26	1,452	32
Consumer	139	148		100	
Total	<u>\$ 4,501</u>	<u>\$ 5,807</u>	<u>\$ 175</u>	<u>\$ 7,128</u>	<u>\$ 104</u>
<b>December 31, 2020</b>					
With no related allowance:					
Commercial	\$ 2,251	\$ 3,421		\$ 2,915	\$ 30
Real estate:					
Commercial	2,372	2,964		2,148	28
Residential	1,086	1,263		1,223	21
Consumer	111	121		167	
Total	<u>5,820</u>	<u>7,769</u>		<u>6,453</u>	<u>79</u>
With an allowance recorded:					
Commercial	2,046	2,094	947	2,038	17
Real estate:					
Commercial	1,580	1,710	180	1,687	36
Residential	460	482	75	624	13
Consumer					
Total	<u>4,086</u>	<u>4,286</u>	<u>1,202</u>	<u>4,349</u>	<u>66</u>
Total impaired loans					
Commercial	4,297	5,515	947	4,953	47
Real estate:					
Commercial	3,952	4,674	180	3,835	64
Residential	1,546	1,745	75	1,847	34
Consumer	111	121		167	
Total	<u>\$ 9,906</u>	<u>\$ 12,055</u>	<u>\$ 1,202</u>	<u>\$ 10,802</u>	<u>\$ 145</u>



December 31, 2019	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the Year Ended	
				Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Commercial	\$ 3,638	\$ 4,175		\$ 3,907	\$ 63
Real estate:					
Commercial	1,918	2,205		2,385	38
Residential	1,718	2,060		1,362	25
Consumer	261	274		233	
Total	<u>7,535</u>	<u>8,714</u>		<u>7,887</u>	<u>126</u>
With an allowance recorded:					
Commercial	1,020	1,038	\$ 363	1,012	32
Real estate:					
Commercial	1,130	1,811	279	1,050	10
Residential	435	450	135	1,408	29
Consumer				20	
Total	<u>2,585</u>	<u>3,299</u>	<u>777</u>	<u>3,490</u>	<u>71</u>
Total impaired loans					
Commercial	4,658	5,213	363	4,919	95
Real estate:					
Commercial	3,048	4,016	279	3,435	48
Residential	2,153	2,510	135	2,770	54
Consumer	261	274		253	
Total	<u>\$ 10,120</u>	<u>\$ 12,013</u>	<u>\$ 777</u>	<u>\$ 11,377</u>	<u>\$ 197</u>

The amounts of interest income recognized using the cash-basis method on impaired loans for the years ended December 31, 2021, 2020 and 2019 were \$100, \$142 and \$181, respectively.

Included in the commercial loan, commercial real estate and residential real estate categories are troubled debt restructurings that were classified as impaired. Trouble debt restructurings totaled \$1,649 and \$2,818 at December 31, 2021 and 2020 respectively. The decrease in trouble debt restructured balances is due primarily to a payoff of a \$0.5 million commercial credit, and receipt of \$0.4 million from the SBA for the guaranteed portion of a commercial loan.

There were no loans modified in 2021 that resulted in trouble debt restructurings (“TDRs”). There were four loans modified in 2020 and one loan modified in 2019 that resulted in TDRs. The four loans modified in 2020 were adversely impacted by COVID-19 and the economic slowdown and did not qualify for the CARES Act exclusion due to current and prior delinquencies. Two of the loans were to one restaurant and two of the loans were to retail related small businesses. The following tables summarize the loans whose terms have been modified resulting in TDRs during the year ended December 31, 2021 and 2020 and 2019.

<b>December 31, 2021</b>	<b>Number of Contracts</b>	<b>Pre-Modification Outstanding Recorded Investment</b>	<b>Post-Modification Outstanding Recorded Investment</b>	<b>Recorded Investment</b>
Commercial		\$	\$	\$
Commercial real estate				
<b>Total</b>		<b>\$</b>	<b>\$</b>	<b>\$</b>

<b>December 31, 2020</b>	<b>Number of Contracts</b>	<b>Pre-Modification Outstanding Recorded Investment</b>	<b>Post-Modification Outstanding Recorded Investment</b>	<b>Recorded Investment</b>
Commercial	1	\$ 12	\$ 12	\$ 5
Commercial real estate	3	\$ 1,073	\$ 1,073	\$ 1,046
<b>Total</b>	<b>4</b>	<b>\$ 1,085</b>	<b>\$ 1,085</b>	<b>\$ 1,051</b>

<b>December 31, 2019</b>	<b>Number of Contracts</b>	<b>Pre-Modification Outstanding Recorded Investment</b>	<b>Post-Modification Outstanding Recorded Investment</b>	<b>Recorded Investment</b>
Commercial real estate	1	\$ 346	\$ 346	\$ 241

There were no payment defaults within 12 months of its modification on loans considered TDRs for the years ended December 31, 2021, December 31, 2020 and December 31, 2019.

The Company received a significant number of requests to modify loan terms and/or defer principal and/or interest payments from borrowers affected by COVID-19, and had agreed to many such deferrals. The federal banking regulators issued guidance and encouraged banks to work prudently with, and provide short-term payment accommodations to borrowers affected by COVID-19. Section 4013 of the CARES Act includes a provision for the Company to opt out of applying the TDR guidance for certain loan modifications and specified that such modifications made on loans that were current as of December 31, 2019 do not need to be classified as TDRs. Peoples applied this guidance. The payment modifications granted included principal only payments and principal and interest deferrals and generally ranged from 90 to 180 days. The modified loans were not considered past due unless the modified payment was delinquent. Similarly, FASB has confirmed that short-term modifications made on a good-faith basis in response to COVID-19 to loan customers who were current prior to any relief are not TDRs.

Beginning in March 2020, the Company began receiving requests for temporary modifications to the repayment structure for borrower loans. During 2020, the Company made a total of 479 commercial loan and 512 consumer loan temporary modifications with principal balances totaling \$330,119. At December 31, 2021, all loans have returned to original payment terms.

##### **5. Off-balance sheet financial instruments:**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused portions of lines of credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, unused portions of lines of credit and standby letters of credit is represented by the contractual amounts of those instruments. The Company follows the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company records a valuation allowance for off-balance sheet credit losses, if deemed necessary, separately as a liability. The allowance is not significant.

The contractual amounts of off-balance sheet commitments at December 31, 2021 and 2020 are summarized as follows:

<u>December 31</u>	<u>2021</u>	<u>2020</u>
Commitments to extend credit	\$ 431,011	\$ 336,667
Unused portions of lines of credit	64,108	55,391
Standby letters of credit	58,254	34,428
	<u>\$ 553,373</u>	<u>\$ 426,486</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Unused portions of lines of credit, including home equity and overdraft protection agreements, are commitments for possible future extensions of credit to existing customers. Unused portions of home equity lines are collateralized and generally have fixed expiration dates. Overdraft protection agreements are uncollateralized and usually do not carry specific maturity dates. Unused portions of lines of credit ultimately may not be drawn upon to the total extent to which the Company is committed.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all standby letters of credit expire within twelve months. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these standby letters of credit as deemed necessary. Collateral supporting standby letters of credit amounted to \$777 at December 31, 2021 and \$4,902 at December 31, 2020. The carrying value of the liability for the Company's obligations under guarantees for standby letters of credit was not material at December 31, 2021 and 2020.

#### **6. Premises and equipment, net:**

Premises and equipment at December 31, 2021 and 2020 are summarized as follows:

<u>December 31</u>	<u>2021</u>	<u>2020</u>
Land	\$ 7,255	\$ 5,217
Premises and leasehold improvements	50,426	48,596
Right-of-use assets	8,563	6,282
Furniture, fixtures and equipment	19,096	18,395
	<u>85,340</u>	<u>78,490</u>
Less: accumulated depreciation	33,838	31,445
	<u>\$ 51,502</u>	<u>\$ 47,045</u>

The increase in land at December 31, 2021 is due to the purchase of a property in Doylestown, PA for the construction of a new branch office. The construction of the branch is contracted at a total cost of \$2.3 million.

#### **7. Operating lease commitments and contingencies:**

The Company is obligated under non-cancelable operating leases for certain branch locations. We determine if an arrangement is a lease at inception by assessing whether a contract contains a right to control an identified asset for a

period of time in exchange for consideration. For all leases, we recognize a right-of-use asset and lease liability at the effective date of the lease. Operating leases right-of-use assets are included in premises and equipment, and lease liabilities are included in other liabilities in the consolidated balance sheet commencing at January 1, 2019. We have no finance leases. Leases with an initial term of 12 months or less are not recorded on the balance sheet and the related lease expense is recognized on a straight-line basis over the lease term.

Certain leases include options to renew, with renewal terms generally containing one or more five-year renewal options. At December 31, 2021, the Company's leases have remaining renewal terms that can extend the lease term from seven years to thirty-one years that are reasonably certain of being exercised. The weighted average remaining lease term at December 31, 2021 is sixteen years. At December 31, 2020, the weighted average remaining lease term was thirteen years. The discount rate used in determining the lease liability for each individual lease was the FHLB fixed advance rate which corresponded with the remaining lease term as of January 1, 2019 for leases that existed at adoption. The discount rate used for two new leases added in 2021 was the annual percentage increase outlined in the terms of each lease. At December 31, 2021, discount rates ranged from 1.60% to 3.85% with an average discount rate of 2.99%. At December 31, 2020, discount rates ranged from 1.95% to 3.85% with an average discount rate of 3.19%.

At December 31, 2021, right-of-use assets of \$8,563 were included in premises and equipment, and the related lease liability totaled \$8,790 and was included in other liabilities in the consolidated balance sheet. Right-of-use assets and the related lease liability were \$6,282 and \$6,425, respectively, at December 31, 2020. The lease liability increased at December 31, 2021 due to the addition of two new leases, one for the relocation of our Binghamton branch to a newly constructed facility and one for the opening of our newest branch in Piscataway, New Jersey. The initial increase to the lease liability for the two new leases totaled \$2,731. Offsetting the lease liability were payments of \$644 offset by lease expense of \$278. One additional lease was entered into and added \$899 to the liability in 2020. Rent expense for the years ended December 31, 2021, 2020 and 2019 amounted to \$760, \$727, and \$670, respectively, and is included in occupancy expenses.

Future minimum lease payments under operating leases are summarized as follows:

2022	\$ 791
2023	736
2024	669
2025	688
2026	691
Thereafter	7,914
Total future minimum lease payments	11,489
Less amount representing interest	(2,699)
Present value of future minimum lease payments	<u>\$ 8,790</u>

## 8. Intangible assets, net:

The gross carrying amount of core deposit intangible assets totaled \$8,146 at December 31, 2021 and 2020. The gross carrying amount of trade name intangible assets totaled \$203 at December 31, 2021 and 2020. The gross carrying amount of the intangible asset related to the acquisition of an asset management and retirement plan services company acquired in 2015 totaled \$1,091 at December 31, 2021 and 2020. The accumulated amortization on core deposit intangible assets was \$7,831 and \$7,507 at December 31, 2021 and 2020, respectively. The accumulated amortization trade name intangible assets was \$193 and \$182 at December 31, 2021 and 2020, respectively. The accumulated amortization on the asset management and retirement plan services intangible asset was \$947 and \$792 at December 31, 2021 and 2020, respectively.

The estimated amortization expense on intangible assets in years subsequent to December 31, 2021, is as follows:

2022	\$ 363
2023	105
Total	<u>\$ 468</u>

**9. Other assets:**

The major components of other assets at December 31, 2021 and 2020 are summarized as follows:

	<u>December 31, 2021</u>	<u>December 31, 2020</u>
Other real estate owned	\$ 609	\$ 864
Investment in low income housing partnership	5,900	6,332
Mortgage servicing rights	882	838
Restricted equity securities (FHLB and other)	4,045	5,397
Net deferred tax asset	5,355	3,768
Interest rate floor	844	1,678
Interest rate swaps	9,026	13,693
Other assets	6,395	6,345
Total	<u>\$ 33,056</u>	<u>\$ 38,915</u>

The Company originates one-to-four family residential mortgage loans for sale in the secondary market with servicing rights retained. Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were \$151,604 at December 31, 2021 and \$166,472 at December 31, 2020.

## 10. Deposits:

The major components of interest-bearing and noninterest-bearing deposits at December 31, 2021 and 2020 are summarized as follows:

At the period end	December 31, 2021	December 31, 2020
<b>Interest-bearing deposits:</b>		
Money market accounts	\$ 588,245	\$ 496,634
Now accounts	851,086	567,087
Savings accounts	491,796	431,224
Time deposits less than \$250	203,719	221,446
Time deposits \$250 or more	90,795	98,247
Total interest-bearing deposits	2,225,641	1,814,638
<b>Noninterest-bearing deposits</b>	737,756	622,475
Total deposits	\$ 2,963,397	\$ 2,437,113

The aggregate amounts of maturities for all time deposits at December 31, 2021, are summarized as follows:

2022	\$ 212,919
2023	35,336
2024	17,965
2025	7,731
2026	9,985
Thereafter	10,578
	\$ 294,514

The aggregate amount of deposits reclassified as loans was \$184 at December 31, 2021, and \$245 at December 31, 2020. Management evaluates transaction accounts that are overdrawn for collectability as part of its evaluation for credit losses.

## 11. Short-term borrowings:

Short-term borrowings consisted of FHLB advances representing overnight borrowings or borrowings with original terms of less than twelve months at December 31, 2021, 2020 and 2019:

	At and for the year ended December 31, 2021				
	Ending Balance	Average Balance	Maximum Month-End Balance	Weighted Average Rate	Weighted Average Rate at End of the Year
FHLB advances	\$ 50,000	\$ 13,973	\$ 50,000	0.56 %	
	At and for the year ended December 31, 2020				
	Ending Balance	Average Balance	Maximum Month-End Balance	Weighted Average Rate for the Year	Weighted Average Rate at End of the Year
FHLB advances	\$ 50,000	\$ 83,716	\$ 179,199	1.01 %	0.40 %
	At and for the year ended December 31, 2019				
	Ending Balance	Average Balance	Maximum Month-End Balance	Weighted Average Rate for the Year	Weighted Average Rate at End of the Year
FHLB advances	\$ 152,150	\$ 62,941	\$ 152,150	2.61 %	1.84 %

The Company has an agreement with the FHLB which allows for borrowings up to its maximum borrowing capacity based on a percentage of qualifying collateral assets. At December 31, 2021, the maximum borrowing capacity was \$896,130 of which \$2,711 was outstanding in borrowings and \$373,035 was used to issue standby letters of credit to collateralize public fund deposits. Advances with the FHLB are secured under terms of a blanket collateral agreement by a pledge of FHLB stock and certain other qualifying collateral, such as investments and mortgage-backed securities and mortgage loans. Interest accrues daily on the FHLB advances based on rates of the FHLB discount notes. This rate resets each day.

The Company also has unsecured line of credit agreements with two correspondent banks, where the total line amount was \$18,000 at December 31, 2021 and 2020. There were no amounts outstanding on either line of credit at December 31, 2021 or 2020. Interest on these borrowings accrues daily based on the daily federal funds rate.

## 12. Long-term debt:

Long-term debt consisting of advances from the FHLB at December 31, 2021 and 2020 are as follows:

Due	Interest Rate		December 31, 2021	December 31, 2020
	Fixed			
June 2021	1.99			\$ 10,000
March 2023	4.69	\$	2,711	4,769
		\$	2,711	\$ 14,769

Maturities of long-term debt, by contractual maturity, in years subsequent to December 31, 2021 are as follows:

2022	2,156
2023	555
	<u>\$ 2,711</u>

None of the advances from the FHLB are convertible. At December 31, 2021, long-term debt are all at fixed rates. There were no new long-term advances entered into with the FHLB during 2021 or 2020.

## 13. Subordinated debt:

On June 1, 2020, the Company sold \$33,000 aggregate principal amount of Subordinated Notes due 2030 (the "2020 Notes") to accredited investors. The 2020 Notes qualify as Tier 2 capital for regulatory capital purposes.

The 2020 Notes bear interest at a rate of 5.375% per year for the first five years and then float based on a benchmark rate (as defined), provided that the interest rate applicable to the outstanding principal balance during the period the 2020 Notes are floating will at no time be less than 4.75%. Interest is payable semi-annually in arrears on June 1 and December 1 of each year, beginning on June 1, 2020, for the first five years after issuance and payable quarterly in arrears thereafter on March 1, June 1, September 1, and December 1. The 2020 Notes mature on June 1, 2030 and are redeemable in whole or in part, without premium or penalty, at any time on or after June 1, 2025 and prior to June 1, 2030. Additionally, if all or any portion of the 2020 Notes cease to be deemed Tier 2 Capital, the Company may redeem, in whole and not in part, at any time upon giving not less than ten days' notice, an amount equal to one hundred percent (100%) of the principal amount outstanding plus accrued but unpaid interest to but excluding the date fixed for redemption.

Holders of the 2020 Notes may not accelerate the maturity of the 2020 Notes, except upon the bankruptcy, insolvency, liquidation, receivership or similar proceeding by or against the Company.

#### 14. Fair value of financial instruments:

Assets and liabilities measured at fair value on a recurring basis at December 31, 2021 and 2020 are summarized as follows:

December 31, 2021	Amount	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury securities	\$ 191,574	\$ 191,574		\$
U.S. government-sponsored enterprises	33,778		\$ 33,778	
State and municipals:				
Taxable	68,978		68,978	
Tax-exempt	98,250		98,250	
Mortgage-backed securities:				
U.S. government agencies	1,843		1,843	
U.S. government-sponsored enterprises	119,980		119,980	
Corporate debt securities	2,918		2,918	
Common equity securities	140	140		
Total investment securities	<u>\$ 517,461</u>	<u>\$ 191,714</u>	<u>\$ 325,747</u>	<u>\$</u>
Loan held for sale	<u>\$ 408</u>		<u>\$ 408</u>	
Interest rate floor-other assets	<u>\$ 844</u>		<u>\$ 844</u>	
Interest rate swap-other assets	<u>\$ 9,026</u>		<u>\$ 9,026</u>	
Interest rate swap-other liabilities	<u>\$ (8,811)</u>		<u>\$ (8,811)</u>	

December 31, 2020	Amount	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury securities	\$ 18,905	\$ 18,905		\$
U.S. government-sponsored enterprises	65,188		\$ 65,188	
State and municipals:				
Taxable	55,366		55,366	
Tax-exempt	56,994		56,994	
Mortgage-backed securities:				
U.S. government agencies	3,707		3,707	
U.S. government-sponsored enterprises	94,751		94,751	
Corporate debt securities	1,000		1,000	
Common equity securities	138	138		
Total investment securities	<u>\$ 296,049</u>	<u>\$ 19,043</u>	<u>\$ 277,006</u>	<u>\$</u>
Loan held for sale	<u>\$ 837</u>		<u>\$ 837</u>	
Interest rate floor-other assets	<u>\$ 1,678</u>		<u>\$ 1,678</u>	
Interest rate swap-other assets	<u>\$ 13,693</u>		<u>\$ 13,693</u>	
Interest rate swap-other liabilities	<u>\$ (14,099)</u>		<u>\$ (14,099)</u>	



Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2021 and 2020 are summarized as follows:

	Amount	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2021</b>				
Impaired loans	\$ 780			\$ 780
Other real estate owned	\$ 487			\$ 487

	Amount	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2020</b>				
Impaired loans	\$ 2,884			\$ 2,884
Other real estate owned	\$ 527			\$ 527

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range
				(Weighted Average)
<b>December 31, 2021</b>				
Impaired loans	\$ 780	Appraisal of collateral	Appraisal adjustments	6.4% to 97.0% (65.2)%
			Liquidation expenses	3.0% to 6.0% (5.1)%
Other real estate owned	\$ 487	Appraisal of collateral	Appraisal adjustments	35.9% to 35.9% (35.9)%
			Liquidation expenses	3.0% to 6.0% (5.0)%

	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range
				(Weighted Average)
<b>December 31, 2020</b>				
Impaired loans	\$ 2,884	Appraisal of collateral	Appraisal adjustments	9.0% to 97.0% (28.2)%
			Liquidation expenses	3.0% to 6.0% (5.5)%
Other real estate owned	\$ 527	Appraisal of collateral	Appraisal adjustments	3.1% to 58.1% (29.9)%
			Liquidation expenses	3.0% to 6.0% (5.0)%

Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The carrying and fair values of the Company's financial instruments at December 31, 2021 and 2020 and their placement within the fair value hierarchy are as follows:

December 31, 2021	Carrying Value	Fair Value	Fair Value Hierarchy		
			Quoted Prices in Active Markets for Identical Assets (level 1)	Significant Other Observable Inputs (level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial assets:</b>					
Cash and due from banks	\$ 279,933	\$ 279,933	\$ 279,933		
<b>Investment securities:</b>					
Available-for-sale	517,321	517,321	191,574	\$ 325,747	
Common equity securities	140	140	140		
Held-to-maturity	71,213	70,446		70,446	
Loans held for sale	408	408		408	
Net loans	2,300,790	2,261,586			\$ 2,261,586
Accrued interest receivable	8,528	8,528		8,528	
Mortgage servicing rights	882	1,357		1,357	
Restricted equity securities (FHLB and other)	4,045	4,045		4,045	
Interest rate floor	844	844		844	
Interest rate swaps	9,026	9,026		9,026	
Total	<u>\$ 3,193,130</u>	<u>\$ 3,153,634</u>			
<b>Financial liabilities:</b>					
Deposits	\$ 2,963,397	\$ 2,963,547		\$ 2,963,547	
Long-term debt	2,711	2,778		2,778	
Subordinated debentures	33,000	32,337		32,337	
Accrued interest payable	408	408		408	
Interest rate swaps	8,811	8,811		8,811	
Total	<u>\$ 3,008,327</u>	<u>\$ 3,007,881</u>			

December 31, 2020	Carrying Value	Fair Value	Fair Value Hierarchy		
			Quoted Prices in Active Markets for Identical Assets (level 1)	Significant Other Observable Inputs (level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial assets:</b>					
Cash and due from banks	\$ 228,192	\$ 228,192	\$ 228,192		
<b>Investment securities:</b>					
Available-for-sale	295,911	295,911	18,905	\$ 277,006	
Common equity securities	138	138	138		
Held-to-maturity	7,225	7,513		7,513	
Loans held for sale	837	837		837	
Net loans	2,150,638	2,145,752			\$ 2,145,752
Accrued interest receivable	8,255	8,255		8,255	
Mortgage servicing rights	838	1,269		1,269	
Restricted equity securities (FHLB and other)	5,397	5,397		5,397	
Interest rate floor	1,678	1,678		1,678	
Interest rate swaps	13,693	13,693		13,693	
Total	<u>\$ 2,712,802</u>	<u>\$ 2,708,635</u>			
<b>Financial liabilities:</b>					
Deposits	\$ 2,437,113	\$ 2,441,014		\$ 2,441,014	
Long-term debt	14,769	15,073		15,073	
Subordinated debentures	33,000	33,096		33,096	
Accrued interest payable	736	736		736	
Interest rate swaps	14,099	14,099		14,099	
Total	<u>\$ 2,499,717</u>	<u>\$ 2,504,018</u>			

## 15. Derivatives and hedging activities:

### Risk Management Objective of Using Derivatives

The Company is exposed to certain risk arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its assets and liabilities and the use of derivative financial instruments. Specifically, the Company enters 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. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts principally related to the Company's assets and borrowings.

### Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest income/expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps and floors as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. Interest rate floors designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty if interest rates fall below the strike rate on the contract in exchange for an up-front premium. During 2020, such derivatives were used to hedge the variable cash flows associated with existing variable-rate assets and issuances of debt. During the twelve months ended

December 31, 2021, the Company terminated the interest rate swap associated with floating-rate borrowings and accelerated the reclassification of amounts in other comprehensive income to earnings as a result of the hedged forecasted transactions becoming probable not to occur. The accelerated amount was a loss of \$25.

For derivatives 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 (loss) and subsequently reclassified into interest expense/income in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income (loss) related to derivatives will be reclassified to interest expense/income as interest payments are made/received on the Company's variable-rate debt/assets. During the next twelve months, the Company estimates that an additional \$452 will be reclassified as an increase to interest income.

### Non-designated Hedges

Derivatives not designated as hedges are not speculative and result from a service the Company provides to certain customers. The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of December 31, 2021, the Company had 84 interest rate swaps with an aggregate notional amount of \$392,677 related to this program.

### Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the consolidated balance sheets as of December 31, 2021 and December 31, 2020.

	Notional Amount	Asset Derivatives As of December 31, 2021 (1)		Asset Derivatives As of December 31, 2020		Liability Derivatives As of December 31, 2021 (1)		Liability Derivatives As of December 31, 2020	
		Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments									
Interest Rate Floor	\$ 25,000	Other Assets	\$ 844	Other Assets	\$ 1,678				
Cash Flow Swap	\$ 50,000					Other Liabilities	\$	Other Liabilities	\$ 485
Total derivatives designated as hedging instruments			\$ 844		\$ 1,678		\$		\$ 485
Derivatives <b>not</b> designated as hedging instruments									
Interest Rate Swaps (2)	\$ 392,677	Other Assets	\$ 9,026	Other Assets	\$ 13,693	Other Liabilities	\$ 8,811	Other Liabilities	\$ 13,614
Total derivatives <b>not</b> designated as hedging instruments			\$ 9,026		\$ 13,693		\$ 8,811		\$ 13,614

(1) Amounts include accrued interest

(2) Notional amount of interest rate swaps at December 31, 2020 were \$375,341

## Effect of Fair Value and Cash Flow Hedge Accounting on Accumulated Other Comprehensive Income (Loss)

The table below presents the effect of fair value and cash flow hedge accounting on accumulated other comprehensive income (loss) as of December 31, 2021 and December 31, 2020.

Derivatives in Hedging Relationships	Amount of	Amount of	Amount of	Location of	Amount of	Amount of	Amount of
	Gain (Loss) Recognized in	Gain (Loss) Recognized in	Loss Recognized in	Gain or (Loss) Recognized from Accumulated Other Comprehensive Income into Income	Gain (Loss) Reclassified from Accumulated OCI into Income	Gain (Loss) Reclassified from Accumulated OCI into Income	Gain (Loss) Reclassified from Accumulated OCI into Income
	OCI on Derivative	OCI Included Component	OCI Excluded Component				
		December 31, 2021				December 31, 2021	
Derivatives in Cash Flow Hedging Relationships							
Cash Flow Swap	\$ 401	\$ 401		Interest Expense	\$ (23)	\$ (23)	
Cash Flow Swap				Other expense	(25)	(25)	
Interest Rate Floor (*)	(228)	(245)	17	Interest Income	543	607	(64)
Total	\$ 173	\$ 156	\$ 17		\$ 495	\$ 559	\$ (64)

Derivatives in Hedging Relationships	Amount of	Amount of	Amount of	Location of	Amount of	Amount of	Amount of
	Gain Recognized in	Gain Recognized in	Gain Recognized in	Gain or (Loss) Recognized from Accumulated Other Comprehensive Income into Income	Loss Reclassified from Accumulated OCI into Income	Gain Reclassified from Accumulated OCI into Income	Loss Reclassified from Accumulated OCI into Income
	OCI on Derivative	OCI Included Component	OCI Excluded Component				
		December 31, 2020				December 31, 2020	
Derivatives in Cash Flow Hedging Relationships							
Cash Flow Swap	\$ (437)	\$ (437)		Interest Expense	\$ 13	\$ 13	
Interest Rate Floor (*)	1,178	1,232	(54)	Interest Income	414	478	(64)
Total	\$ 741	\$ 795	\$ (54)		\$ 427	\$ 491	\$ (64)

\* Amounts disclosed are gross and not net of taxes.

## Effect of Fair Value and Cash Flow Hedge Accounting on the Consolidated Statements of Income and Comprehensive Income

The table below presents the effect of the Company's derivative financial instruments on the consolidated statements of income and comprehensive income as of December 31, 2021 and December 31, 2020.

	Location and Amount of Gain or (Loss) Recognized in Income on Fair Value and Cash Flow Hedging Relationships			
	For the twelve months ended December 31,			
	2021	2021	2020	2020
	Interest Income	Interest Expense	Interest Income	Interest Expense
Total amounts of income and expense line items presented in the statements of income and comprehensive income in which the effects of fair value or cash flow hedges are recorded	\$ 543	\$ (48)	\$ 413	\$ 13
<b>The effects of fair value and cash flow hedging:</b>				
<b>Gain or (loss) on cash flow hedging relationships</b>				
Interest contracts				
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income	\$ 543	\$ (23)	\$ 413	\$ 13
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income as a result that a forecasted transaction is no longer probable of occurring		\$ (25)		
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income - included component	\$ 607	\$ (48)	\$ 477	\$ 13
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income - excluded component	\$ (64)		\$ (64)	

## Effect of Derivative Instruments on the Consolidated Statements of Income and Comprehensive Income

The tables below present the effect of the Company's other derivative financial instruments on the consolidated statements of income and comprehensive income for the years ended December 31, 2021 and 2020.

<u>Derivatives Not Designated as Hedging Instruments</u>	<u>Location of Gain or (Loss) Recognized in Income on Derivative</u>	<u>Amount of Gain Recognized in Income</u>	<u>Amount of Gain Recognized in Income</u>
		<u>Twelve Months Ended December 31, 2021</u>	<u>Twelve Months Ended December 31, 2020</u>
Interest Rate Swaps	Interest rate swap revenue	\$ 136	\$ 31
Fee Income	Fee income	\$ 623	\$ 2,290

### Offsetting Derivatives

The table below presents a gross presentation, the effects of offsetting, and a net presentation of the Company's derivatives as of December 31, 2021 and December 31, 2020. The net amounts of derivative assets or liabilities can be reconciled to the tabular disclosure of fair value. The tabular disclosure of fair value provides the location that derivative assets and liabilities are presented on the consolidated balance sheets.

#### Offsetting of Derivative Assets as of December 31, 2021

	<u>Gross Amounts of Recognized Assets</u>	<u>Gross Amounts Offset in the Balance Sheet</u>	<u>Net Amounts of Assets presented in the Balance Sheet</u>	<u>Gross Amounts Not Offset in the Balance Sheet</u>		
				<u>Financial Instruments</u>	<u>Cash Collateral Received</u>	<u>Net Amount</u>
Derivatives	\$ 9,870	\$	\$ 9,870	\$ 3,218		\$ 6,652

#### Offsetting of Derivative Liabilities as of December 31, 2021

	<u>Gross Amounts of Recognized Assets</u>	<u>Gross Amounts Offset in the Balance Sheet</u>	<u>Net Amounts of Assets presented in the Balance Sheet</u>	<u>Gross Amounts Not Offset in the Balance Sheet</u>		
				<u>Financial Instruments</u>	<u>Cash Collateral Paid</u>	<u>Net Amount</u>
Derivatives	\$ 8,818	\$	\$ 8,818	\$ 3,218	\$ 5,600	\$

#### Offsetting of Derivative Assets as of December 31, 2020

	<u>Gross Amounts of Recognized Assets</u>	<u>Gross Amounts Offset in the Balance Sheet</u>	<u>Net Amounts of Assets presented in the Balance Sheet</u>	<u>Gross Amounts Not Offset in the Balance Sheet</u>		
				<u>Financial Instruments</u>	<u>Cash Collateral Received</u>	<u>Net Amount</u>
Derivatives	\$ 15,371	\$	\$ 15,371	\$ 1,678		\$ 13,693

#### Offsetting of Derivative Liabilities as of December 31, 2020

	<u>Gross Amounts of Recognized Assets</u>	<u>Gross Amounts Offset in the Balance Sheet</u>	<u>Net Amounts of Assets presented in the Balance Sheet</u>	<u>Gross Amounts Not Offset in the Balance Sheet</u>		
				<u>Financial Instruments</u>	<u>Cash Collateral Paid</u>	<u>Net Amount</u>
Derivatives	\$ 14,099	\$	\$ 14,099	\$ 1,678	\$ 12,421	\$

## **Credit-risk-related Contingent Features**

The Company has agreements with certain of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company also has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well capitalized institution, then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

As of December 31, 2021, the termination value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$5,600. As of December 31, 2020, the termination value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$12,421. The Company has minimum collateral posting thresholds with certain of its derivative counterparties, and has posted collateral of \$7,380 against its obligations under these agreements as of December 31, 2021, compared to having posted collateral of \$15,360 with counterparties at December 31, 2020. Cash collateral represents the amount that cannot be used to offset our derivative assets and liabilities from a gross basis to a net basis in accordance with the agreement. The cash collateral is exchanged under bilateral collateral and master netting agreements that allow us to offset the net derivative position with the related collateral. The application of the cash collateral cannot reduce the net derivative position below zero. Therefore, excess other collateral, if any, is not reflected above. If the Company had breached any of these provisions it could have been required to settle its obligations under the agreements at the termination value.

## **16. Stock plans:**

In May 2017, the Company's stockholders approved the 2017 equity incentive plan ("2017 Plan"). The 2017 Plan allows for eligible participants to be granted equity awards. Under the 2017 Plan the Compensation Committee of the Board of Directors has the authority to, among other things:

- Select the persons to be granted awards under the 2017 Plan.
- Determine the type, size and term of awards.
- Determine whether such performance objectives and conditions have been met.
- Accelerate the vesting or exercisability of an award.

Persons eligible to receive awards under the 2017 Plan include directors, officers, employees, consultants and other service providers of the Company and its subsidiaries.

As of December 31, 2021, 37,151 shares of the Company's common stock were available for grant as awards pursuant to the 2017 Plan. If any outstanding awards under the 2017 Plan are forfeited by the holder or canceled by the Company, the underlying shares would be available for regrant to others.

The 2017 Plan authorizes grants of stock options, stock appreciation rights, cash awards, performance awards, restricted stock and restricted stock units.

In 2021, the Company awarded 4,403 shares of non-performance-based restricted stock and 15,415 performance-based restricted stock units under the 2017 Plan. In 2020, the Company awarded 3,615 shares of non-performance-based restricted stock and 12,654 performance-based restricted stock units under the 2017 Plan. In 2021, 3,128 shares of non-performance-based and 12,332 shares of performance based restricted stock granted under the 2017 Plan vested and



there were no shares forfeited under the provisions of the 2017 Plan. In 2020, 1,920 shares of non-performance-based and 6,535 shares of performance based restricted stock granted under the 2017 Plan vested and there were 1,875 shares forfeited under the provisions of the 2017 Plan.

The non-performance restricted stock grants made in 2021, 2020 and 2019 vest equally over three years from the grant date. The performance-based restricted stock units vest three years after the grant date and include conditions based on the Company's three year cumulative diluted earnings per share and three-year average return on equity or tangible equity that determines the number of restricted stock units that may vest.

The activity related to the 2017 Plan for each of the years ended December 31, 2021, 2020 and 2019 was as follows:

<b>Year Ended December 31</b>	<b>2021</b>	<b>2020</b>	<b>2019</b>
Nonvested, January 1	31,923	25,984	12,892
Granted shares	19,818	16,269	17,345
Vested shares	15,460	8,455	2,542
Forfeited shares		1,875	1,711
Nonvested, December 31	<u>36,281</u>	<u>31,923</u>	<u>25,984</u>

The Company expenses the fair value of all-share based compensation over the requisite service period commencing at grant date. The fair value of restricted stock is expensed on a straight-line basis. Compensation is recognized over the vesting period and adjusted based on the performance criteria. The Company classifies share-based compensation for employees within "salaries and employee benefits expense" on the Consolidated Statements of Income and Comprehensive Income.

In 2021, the Company recognized \$546 for awards granted under the 2017 Plan. In 2020, the Company recognized \$570 for awards granted under the 2017 Plan. In 2019, the Company recognized \$554 for awards granted. As of December 31, 2021, the Company had \$855 of unrecognized compensation expense associated with restricted stock awards. The remaining cost is expected to be recognized over a weighted average vesting period of 1.7 years.

#### **17. Employee benefit plans:**

The Company sponsors a separate ESOP and Retirement Profit Sharing 401(k) Plan. The Company also maintains SERPs and an employees' pension plan, which is currently frozen.

Under the ESOP, amounts voted by the Company's Board of Directors are paid into the ESOP and each eligible participant is credited with an amount in proportion to their annual compensation or a fixed dollar amount. All contributions to the ESOP are invested in or will be invested primarily in Company stock. Distribution of a participant's ESOP account occurs upon retirement, death or termination in accordance with the plan provisions.

Under the Retirement Profit Sharing Plan, amounts approved by the Board of Directors have been paid into a fund and each participant was credited with an amount in proportion to their annual compensation. Upon retirement, death or termination, each participant is paid the total amount of their credits in the fund in one of a number of optional ways in accordance with the plan provisions. Eligible participants may elect deferrals of up to the maximum amounts permitted by law.

The Company contributed \$334, \$371 and \$357 to the ESOP for 2021, 2020 and 2019. In addition, the Company contribution of \$1,245, \$1,207 and \$1,139 to the Retirement Profit Sharing Plan in 2021, 2020 and 2019, was comprised of a safe harbor contribution of \$678, \$655 and \$627 and a discretionary match of \$567, \$552 and \$512.

The Company established a SERP Plan to replace certain 401(k) plan benefits lost due to compensation limits imposed on qualified plans by federal tax law. The annual benefit is a maximum of 6% of the executive compensation in excess of Federal limits. The total liability associated with this plan was \$161 and \$142 at December 31, 2021 and 2020, respectively. The expense associated with the plan was \$19, \$9 and \$17 for 2021, 2020 and 2019 respectively.

The Company has SERPs for the benefit of certain officers. At December 31, 2021 and 2020, other liabilities include \$2,573 and \$2,351 accrued under the plans. Compensation expense includes approximately \$424, \$461 and \$360 relating to these SERPs for the years ended December 31, 2021, 2020 and 2019, respectively.

Under the Employees' Pension Plan, currently frozen, amounts computed on an actuarial basis were being paid by the Company into a trust fund. The plan provided for fixed benefits payable for life upon retirement at the age of 65, based on length of service and compensation levels as defined in the plan. As of June 22, 2008 no further benefits are being accrued in this plan. Plan assets of the trust fund are invested and administered by the Trust Department of the Company.

Information related to the Employees' Pension Plan is as follows:

December 31	Pension Benefits	
	2021	2020
Change in benefit obligation:		
Benefit obligation, beginning	\$ 19,113	\$ 17,491
Interest cost	419	544
Change in experience gain	(49)	(291)
Change in actuarial assumptions	(603)	2,159
Benefits paid	(814)	(790)
Benefit obligation, ending	18,066	19,113
Change in plan assets:		
Fair value of plan assets, beginning	17,628	16,930
Actual return on plan assets	2,443	1,488
Employer contributions		
Benefits paid	(814)	(790)
Fair value of plan assets, ending	19,257	17,628
Funded status at end of year	\$ 1,191	\$ (1,485)

The Society of Actuaries updated the mortality scale within the mortality tables from MP 2020 to MP 2021 which the Company utilized in its pension plan remeasurements at December 31, 2021 and 2020. The change in the discount rate, coupled with changes in the mortality assumption, resulted in an decrease to the benefit obligation of \$603 in 2021 and an increase of \$2,159 in 2020.

Amounts recognized in the consolidated balance sheets are as follows:

December 31	Pension Benefits	
	2021	2020
(Other Assets)/Other Liabilities	\$ (1,190)	\$ 1,485
Amounts recognized in the accumulated other comprehensive income (loss) consist of:		
Net actuarial gain	(5,868)	(7,977)
Deferred taxes	1,232	1,675
Net amount recognized	\$ (4,636)	\$ (6,302)

The accumulated benefit obligation for the defined benefit pension plan was \$18,066 and \$19,113 at December 31, 2021 and 2020, respectively.

Components of net periodic pension income and other amounts recognized in other comprehensive loss are as follows:

Years Ended December 31,	Pension Benefits		
	2021	2020	2019
Net periodic pension income:			
Interest cost	\$ 419	\$ 544	\$ 639
Expected return on plan assets	(1,288)	(1,236)	(1,084)
Amortization of unrecognized net loss	301	218	227
Net periodic pension income:	(568)	(474)	(218)
Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss):			
Net loss (gain)	419	544	639
Deferred tax	(88)	(114)	(134)
Total recognized in other comprehensive income (loss)	331	430	505
Total recognized in net period pension cost and other comprehensive income (loss)	\$ (237)	\$ (44)	\$ 287

Weighted-average assumptions used to determine benefit obligations and related expenses were as follows:

December 31,	Pension Benefits		
	2021	2020	2019
Discount rate:			
Obligation	2.59 %	2.25 %	3.25 %
Expense	2.25	3.25	4.00
Expected long-term return on plan assets	7.50 %	7.50 %	7.50 %

The expected long-term return on plan assets was determined using average historical returns of the Company's plan assets.

The Company's pension plan weighted-average asset allocations at December 31, 2021 and 2020, by asset category are as follows:

December 31,	2021	2020
Asset Category:		
Cash and cash equivalents	4.8 %	6.8 %
Equity securities	67.4	63.3
Corporate bonds	19.6	20.7
U.S. government securities	8.2	9.2
	100.0 %	100.0 %

Fair value measurement of pension plan assets at December 31, 2021 and 2020 is as follows:

<b>December 31, 2021</b>	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Observable Inputs (Level 2)</b>	<b>Significant Observable Inputs (Level 3)</b>
Cash and cash equivalents	\$ 918	\$ 918		\$
Equity securities:				
U.S. large cap	11,940	11,940		
International	1,039	1,039		
Fixed income securities:				
U.S. Treasuries	214		\$ 214	
U.S. government agencies	1,371		1,371	
Corporate bonds	3,775		3,775	
Total	<u>\$ 19,257</u>	<u>\$ 13,897</u>	<u>\$ 5,360</u>	<u>\$</u>

<b>December 31, 2020</b>	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Observable Inputs (Level 2)</b>	<b>Significant Observable Inputs (Level 3)</b>
Cash and cash equivalents	\$ 1,203	\$ 1,203		\$
Equity securities:				
U.S. large cap	10,266	10,266		
International	888	888		
Fixed income securities:				
U.S. Treasuries	216		\$ 216	
U.S. government agencies	1,400		1,400	
Corporate bonds	3,655		3,655	
Total	<u>\$ 17,628</u>	<u>\$ 12,357</u>	<u>\$ 5,271</u>	<u>\$</u>

The Company investment policies and strategies with respect to the pension plan include: (i) the Trust and Investment Division's equity philosophy is large-cap core with a value bias (we invest in individual high-grade common stocks that are selected from our approved list); (ii) diversification is maintained by having no more than 20% in any industry sector and no individual equity representing more than 10% of the portfolio; and (iii) the fixed income style is conservative but also responsive to the various needs of our individual clients. Fixed income securities consist of U.S. government agencies or corporate bonds rated "A" or better. The Company targets the following allocation percentages: (i) cash equivalents 10%; (ii) fixed income 40%; and (iii) equities 50%.

There is no Company stock included in equity securities at December 31, 2021 or 2020. The Company has not determined the amount of the expected contribution to the Employees' Pension Plan for 2021.

The following benefit payments are expected to be paid in the next five years and in the aggregate for the five years thereafter:

	<b>Pension Benefits</b>
2022	\$ 878
2023	901
2024	952
2025	984
2026	1,015
Thereafter	5,020

## 18. Income taxes:

The current and deferred amounts of the provision for income taxes expense (benefit) for each of the years ended December 31, 2021, 2020 and 2019 are summarized as follows:

Year Ended December 31	2021		2020		2019	
Current	\$	9,548	\$	6,600	\$	2,761
Deferred		450		(1,779)		394
Total income tax expense	\$	9,998	\$	4,821	\$	3,155

The components of the net deferred tax asset at December 31, 2021 and 2020 are summarized as follows:

December 31	2021		2020	
Deferred tax assets:				
Allowance for loan losses	\$	5,960	\$	5,742
Lease liability		1,846		1,349
Defined benefit plan				1,108
Deferred compensation		884		789
Deferred loan fees		1,215		1,368
Investment securities available-for-sale		379		
Other		86		170
Total		10,370		10,526
Deferred tax liabilities:				
Lease right-of-use assets		1,798		1,319
Premises and equipment, net		1,441		1,455
Merger related accounting		572		694
Deferred loan costs		885		936
Defined benefit plan		75		
Investment securities available-for-sale				2,033
Other		244		321
Total		5,015		6,758
Net deferred tax asset	\$	5,355	\$	3,768

Management believes that future taxable income will be sufficient to utilize deferred tax assets. Core earnings of the Company have remained strong and will continue to support the recognition of the deferred tax asset based on future growth projections.

A reconciliation between the amount of the effective income tax expense and the income tax expense that would have been provided at the federal statutory rate of 21.0 percent for the years ended December 31, 2021, December 31, 2020 and December 31, 2019 is summarized as follows:

Year Ended December 31	2021		2020		2019	
	Amount	%	Amount	%	Amount	%
Provision for income tax at statutory rate	\$ 11,239	21.00 %	\$ 7,177	21.00 %	\$ 6,067	21.00 %
State tax, net of federal benefit	475	0.89				
Tax exempt interest	(1,194)	(2.23)	(1,032)	(3.02)	(1,299)	(4.50)
Bank owned life insurance income	(119)	(0.22)	(299)	(0.87)	(159)	(0.55)
Residential housing program tax credits	(1,091)	(2.04)	(1,094)	(3.20)	(1,094)	(3.79)
Other, net	688	1.29	69	0.19	(360)	(1.25)
Total	\$ 9,998	18.69 %	\$ 4,821	14.10 %	\$ 3,155	10.91 %

## 19. Parent Company financial statements:

### CONDENSED BALANCE SHEETS

December 31	2021	2020
Assets:		
Cash and cash equivalents	\$ 4,044	\$ 1,069
Equity securities	140	138
Investment in bank subsidiary	368,427	348,584
Other assets	703	273
Total assets	<u>\$ 373,314</u>	<u>\$ 350,064</u>
Liabilities and Stockholders' Equity:		
Subordinated debt	\$ 33,000	33,000
Accrued interest payable	148	148
Other liabilities	39	\$ 39
Stockholders' equity	340,127	316,877
Total liabilities and stockholders' equity	<u>\$ 373,314</u>	<u>\$ 350,064</u>

### CONDENSED STATEMENTS OF INCOME

Year Ended December 31	2021	2020	2019
Income:			
Dividends from subsidiaries	\$ 17,593	\$ 10,518	\$ 10,131
Other income	4	8	8
Net gain realized on sale of equity securities		29	
Unrealized holding gains (losses) on equity securities	2	(35)	132
Total income	<u>17,599</u>	<u>10,520</u>	<u>10,271</u>
Expense:			
Interest expense on subordinated debt	1,774	1,035	
Other expenses	222	200	145
Total expenses	<u>1,996</u>	<u>1,235</u>	<u>145</u>
Income before taxes and undistributed income	15,603	9,285	10,126
Income tax benefit	(410)	(255)	(1)
Income before undistributed income of subsidiaries	16,013	9,540	10,127
Equity in undistributed net income of subsidiaries	27,506	19,814	15,609
Net income	<u>\$ 43,519</u>	<u>\$ 29,354</u>	<u>\$ 25,736</u>

## CONDENSED STATEMENTS OF CASH FLOWS

Year Ended December 31	2021	2020	2019
<b>Cash flows from operating activities:</b>			
Net income	\$ 43,519	\$ 29,354	\$ 25,736
<b>Adjustments:</b>			
Net losses (gains) on investment securities	(2)	6	(132)
Undistributed net income of subsidiaries	(27,506)	(19,814)	(15,609)
Decrease in other assets	(429)	(255)	(302)
Increase (decrease) in other liabilities		148	
Stock based compensation	546	570	554
Increase in due from subsidiaries			1,974
Net cash provided by operating activities	16,128	10,009	12,221
<b>Cash flows from investing activities:</b>			
Purchase of equity securities			
Sale of equity securities		279	
Net cash provided by (used in) investing activities		279	
<b>Cash flows used in financing activities:</b>			
Proceeds from subordinated debt		33,000	
Investment in subsidiary		(30,000)	
Retirement of stock	(2,361)	(6,893)	(634)
Cash dividends paid	(10,792)	(10,518)	(10,131)
Net cash used in financing activities	(13,153)	(14,411)	(10,765)
Increase (decrease) in cash	2,975	(4,123)	1,456
Cash at beginning of year	1,069	5,192	3,736
Cash at end of year	\$ 4,044	\$ 1,069	\$ 5,192

### 20. Regulatory matters:

Dividends are paid by the Parent Company from its assets, which are mainly provided by dividends from Peoples Bank. Under the Pennsylvania Business Corporation Law of 1988, as amended, the Company may not pay a dividend if, after payment, either the Company could not pay its debts as they become due in the usual course of business, or the Company's total assets would be less than its total liabilities. The determination of total assets and liabilities may be based upon: (i) financial statements prepared on the basis of GAAP; (ii) financial statements that are prepared on the basis of other accounting practices and principles that are reasonable under the circumstances; or (iii) a fair valuation or other method that is reasonable under the circumstances. In addition, the Federal Reserve Board has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company's capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a bank holding company experiencing serious financial problems to borrow funds to pay dividends. Under the prompt corrective action regulations, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized."

In addition, under the Pennsylvania Banking Code of 1965, as amended, Peoples Bank may only declare and pay dividends out of accumulated net earnings, or accumulated net earnings acquired as a result of a merger within seven

years. Further, Peoples Bank may not declare or pay any dividend unless Peoples Bank's surplus would not be reduced by the payment of the dividend below 100 percent of our capital stock. Pennsylvania law requires that each year Peoples Bank set aside as surplus, a sum equal to not less than 10 percent of its net earnings if surplus does not equal at least 100 percent of our capital stock. Under federal law and FDIC regulations, an insured bank may not pay dividends if doing so would make it undercapitalized within the meaning of the prompt corrective action law or if in default of its deposit insurance fund assessment.

Although subject to the aforementioned regulatory restrictions, the Company's consolidated retained earnings at December 31, 2021 and 2020 were not restricted under any borrowing agreement as to payment of dividends or reacquisition of common stock.

The Company has paid cash dividends since its formation as a bank holding company in 1986. It is the present intention of the Board of Directors to continue this dividend payment policy, however, further dividends must necessarily depend upon earnings, financial condition, appropriate legal restrictions and other factors relevant at the time the Board of Directors considers payment of dividends.

The amount of funds available for transfer from Peoples Bank to the Company in the form of loans and other extensions of credit is also limited. Under Federal regulation, transfers to any one affiliate are limited to 10.0 percent of capital and surplus. At December 31, 2021, the maximum amount available for transfer from Peoples Bank to the Company in the form of loans amounted to \$33,877. At December 31, 2021 and 2020, there were no loans outstanding, nor were any advances made during 2021 and 2020.

The Company and Peoples Bank are subject to certain regulatory capital requirements administered by the federal banking agencies, which are defined in Section 38 of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"). Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Peoples Bank's consolidated financial statements. In the event an institution is deemed to be undercapitalized by such standards, FDICIA prescribes an increasing amount of regulatory intervention, including the required institution of a capital restoration plan and restrictions on the growth of assets, branches or lines of business. Further restrictions are applied to the significantly or critically undercapitalized institutions including restrictions on interest payable on accounts, dismissal of management and appointment of a receiver. For well capitalized institutions, FDICIA provides authority for regulatory intervention when the institution is deemed to be engaging in unsafe and unsound practices or receives a less than satisfactory examination report rating. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Peoples Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Risk-based capital rules require that banks and holding companies maintain a "capital conservation buffer" of 250 basis points in excess of the "minimum capital ratio." The minimum capital ratio is equal to the prompt corrective action adequately capitalized threshold ratio. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers.

Peoples Bank met the capital requirement for the "well capitalized" category under the regulatory framework for prompt corrective action at December 31, 2021. To be categorized as well capitalized, Peoples Bank must maintain certain minimum Tier I risk-based, total risk-based and Tier I Leverage ratios as set forth in the following tables. The Tier I Leverage ratio is defined as Tier I capital to total average assets less intangible assets. Regulators may assign Peoples Bank to a lower capitalization category based on factors other than capital.



The Company and Peoples Bank's actual capital ratios at December 31, 2021 and 2020, and the minimum ratios required for capital adequacy purposes and to be well capitalized under the prompt corrective action provisions are as follows:

December 31, 2021	Actual		Minimum For Capital Adequacy Purposes		Minimum to be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 capital to risk-weighted assets:						
Consolidated	\$ 281,802	12.32 %	\$ 102,949	4.50 %		
Peoples Bank	310,102	13.76	101,449	4.50	\$ 146,538	6.50 %
Tier 1 capital to risk-weighted assets:						
Consolidated	281,802	12.32	137,266	6.00		
Peoples Bank	310,102	13.76	135,266	6.00	180,355	8.00
Total capital to risk-weighted assets:						
Consolidated	310,185	13.56	183,021	8.00		
Peoples Bank	338,284	15.01	180,355	8.00	225,443	10.00
Tier 1 capital to average assets:						
Consolidated	281,802	9.16	123,013	4.00		
Peoples Bank	310,102	9.58 %	129,476	4.00 %	161,845	5.00 %

December 31, 2020	Actual		Minimum For Capital Adequacy Purposes		Minimum to be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 capital to risk-weighted assets:						
Consolidated	\$ 250,397	12.16 %	\$ 92,631	4.50 %		
Peoples Bank	282,104	13.73	92,461	4.50	\$ 133,554	6.50 %
Tier 1 capital to risk-weighted assets:						
Consolidated	250,397	12.16	123,508	6.00		
Peoples Bank	282,104	13.73	123,281	6.00	164,374	8.00
Total capital to risk-weighted assets:						
Consolidated	310,741	15.10	164,677	8.00		
Peoples Bank	307,807	14.98	164,374	8.00	205,468	10.00
Tier 1 capital to average assets:						
Consolidated	250,397	9.28	107,878	4.00		
Peoples Bank	282,104	10.08 %	111,891	4.00 %	139,864	5.00 %

## 21. Contingencies:

Neither the Company nor any of its property is subject to any material legal proceedings. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising out of pending and threatened lawsuits will have a material effect on the operating results or financial position of the Company.

## 22. Accumulated Other Comprehensive Income (Loss):

The components of accumulated other comprehensive income (loss) included in stockholders' equity at December 31, 2021 and 2020 are as follows:

	December 31, 2021	December 31, 2020
Net unrealized gain (loss) on investment securities available-for-sale	\$ (1,791)	\$ 9,696
Income tax expense (benefit)	(376)	2,036
Net of income taxes	(1,415)	7,660
Benefit plan adjustments	(5,868)	(7,977)
Income tax benefit	(1,232)	(1,675)
Net of income taxes	(4,636)	(6,302)
Derivative adjustments	680	1,002
Income tax	143	211
Net of income taxes	537	791
Accumulated other comprehensive income (loss)	<u>\$ (5,514)</u>	<u>\$ 2,149</u>

Other comprehensive income (loss) and related tax effects for the years ended December 31, 2021, 2020 and 2019 are as follows:

Year Ended December 31,	2021	2020	2019
Unrealized gain (loss) on investment securities available-for-sale	\$ (11,487)	\$ 8,779	\$ 5,109
Net gain on the sale of investment securities available-for-sale (1)	(918)	(918)	(23)
Other comprehensive income on available-for-sale debt securities	(11,487)	7,861	5,086
Benefit plans:			
Amortization of actuarial loss (2)	301	218	227
Actuarial gain (loss)	1,808	(1,616)	412
Net change in benefit plan liabilities	2,109	(1,398)	639
Net change in derivatives	(322)	315	441
Other comprehensive loss before taxes	(9,700)	6,778	6,166
Income tax (benefit)	(2,037)	1,424	1,295
Other comprehensive income (loss)	<u>\$ (7,663)</u>	<u>\$ 5,354</u>	<u>\$ 4,871</u>

- 
- (1) Represents amounts reclassified out of accumulated comprehensive income (loss) and included in gains on sale of investment securities on the consolidated statements of income and comprehensive income.
  - (2) Represents amounts reclassified out of accumulated comprehensive income (loss) and included in the computation of net periodic pension expense. Refer to Note 17 included in these consolidated financial statements.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**  
None.

**Item 9A. Controls and Procedures.**

**Evaluation of Disclosure Controls and Internal Controls**

At December 31, 2021, the end of the period covered by this Annual Report on Form 10-K, the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) evaluated the effectiveness of the Company’s disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, the CEO and CFO concluded that the disclosure controls and procedures, at December 31, 2021, were effective to provide reasonable assurance that information required to be disclosed in the Company’s reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and to provide reasonable assurance that information required to be disclosed in such reports is accumulated and communicated to the CEO and CFO to allow timely decisions regarding required disclosure.

**MANAGEMENT’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

We are responsible for the preparation and fair presentation of the accompanying consolidated balance sheets of Peoples Financial Services Corp. and subsidiaries (the “Company”) as of December 31, 2021 and 2020, and the related consolidated statements of income and comprehensive income, changes in stockholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2021, in accordance with accounting principles generally accepted in the United States. This responsibility includes: establishing, implementing and maintaining adequate internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable under the circumstances. We are also responsible for compliance with the laws and regulations relating to safety and soundness that are designated by the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System and the Pennsylvania Department of Banking and Securities.

Our internal controls are designed to provide reasonable assurance that assets are safeguarded and transactions are initiated, executed, recorded and reported in accordance with our intentions and authorizations and to comply with applicable laws and regulations. The internal control system includes an organizational structure that provides appropriate delegation of authority and segregation of duties, established policies and procedures and comprehensive internal audit and loan review programs. To enhance the reliability of internal controls, we recruit and train highly qualified personnel and maintain sound risk management practices. The internal control system is maintained through a monitoring process that includes a program of internal audits.

Under Section 404 of the Sarbanes-Oxley Act of 2002, we are required to assess the effectiveness of our internal control over financial reporting at the end of each fiscal year and report, based on that assessment, whether the Company’s internal control over financial reporting is effective. Our assessment includes controls over initiating, recording, processing and reconciling account balances, classes of transactions and disclosure and related assertions included in the financial statements. Our assessment also includes controls related to the initiation and processing of non-routine and non-systematic transactions, to the selection and application of appropriate accounting policies and to the prevention, identification and detection of fraud.

There are inherent limitations in any internal control system, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurance with respect to financial statement preparation.

Furthermore, due to changes in conditions, the effectiveness of internal controls may vary over time. Our internal auditor reviews, evaluates and makes recommendations on policies and procedures, which serves as an integral, but independent, component of our internal control.

Our financial reporting and internal controls are under the general oversight of our board of directors, acting through its audit committee. The audit committee is composed entirely of independent directors. The independent registered public

accounting firm and the internal auditor have direct and unrestricted access to the audit committee at all times. The audit committee meets periodically with us, the internal auditor and the independent registered public accounting firm to determine that each is fulfilling its responsibilities and to support actions to identify, measure and control risks and augment internal controls.

Our management, including our CEO and CFO, is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Our management, including our CEO and CFO, assessed the effectiveness of our internal controls over financial reporting as of December 31, 2021 using the criteria established in *Internal Control-Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. These criteria are in the areas of control environment, risk assessment, control activities, information and communication, and monitoring. Our management's assessment included extensive documenting, evaluating and testing the design and operating effectiveness of our internal control over financial reporting.

Based on its assessment, management believes that our internal control over financial reporting was effective as of December 31, 2021.

Baker Tilly US, LLP, the Company's independent registered public accounting firm that audited our consolidated financial statements as of and for the year ended December 31, 2021 has issued an audit report on the Company's internal control over financial reporting as of December 31, 2021. That report is included in Item 8 of this Annual Report on Form 10-K.

/s/ Craig W. Best

Craig W. Best  
Chief Executive Officer  
(Principal Executive Officer)

/s/ John R. Anderson III

John R. Anderson III  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer and  
Principal Accounting Officer)

March 16, 2022

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2021, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information.**

None.

**Item 9C. Disclosure Regarding Foreign Jurisdictions that Prevent Inspections.**

Not applicable.

**PART III****Item 10. Directors, Executive Officers and Corporate Governance.**

We incorporate the information required by this Item 10 by reference to the definitive proxy statement for our 2021 annual meeting of shareholders, to be filed with the Securities and Exchange Commission.

**Item 11. Executive Compensation.**

We incorporate the information required by this Item 11 by reference to the definitive proxy statement for our 2021 annual meeting of shareholders, to be filed with the Securities and Exchange Commission.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

We incorporate the information required by this Item 12 by reference to the definitive proxy statement for our 2021 annual meeting of shareholders, to be filed with the Securities and Exchange Commission.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

We incorporate the information required by this Item 13 by reference to the definitive proxy statement for our 2021 annual meeting of shareholders, to be filed with the Securities and Exchange Commission.

**Item 14. Principal Accounting Fees and Services.**

We incorporate the information required by this Item 14 by reference to the definitive proxy statement for our 2021 annual meeting of shareholders, to be filed with the Securities and Exchange Commission.

**PART IV****Item 15. Exhibits, Financial Statement Schedules.**

- (a) (1). The following consolidated financial statements are set forth in Part II, Item 8:

Report of Independent Registered Public Accounting Firm (PCAOB ID: 23)

Financial Statements:

- Consolidated Balance Sheets
- Consolidated Statements of Income
- Consolidated Statements of Comprehensive Income
- Consolidated Statements of Stockholders' Equity
- Consolidated Statements of Cash Flows
- Notes to Consolidated Financial Statements

- (a) (2). Financial statement schedules are not applicable or included in the financial statements or related notes. The listing of exhibits is set forth on the Exhibit Index beginning on page E-1 and is incorporated in this Item 15 by reference.

**Item 16. Form 10-K Summary.**

We have elected to omit the optional summary of information included in this Form 10-K.

## EXHIBIT INDEX

Exhibit No.	Description of Exhibit
3.1	Peoples Financial Services Corp. Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 to the registrant's Form 10-K filed with the Commission on March 17, 2014).
3.2	Articles of Amendment to the Articles of Incorporation of Peoples Financial Services Corp., effective as of May 19, 2020 (Incorporated by reference to Exhibit 3.2 to registrant's quarterly report on Form 10-Q filed with the Commission on August 10, 2020)
3.3	Amended and Restated Bylaws of Peoples Financial Services Corp. (incorporated by reference to Exhibit 3.1 to the registrant's Form 8-K filed with the Commission on December 2, 2013)
4.1	The Registrant agrees to furnish to the Commission upon request copies of all instruments defining the rights of holders of long-term debt of the registrant and its consolidated subsidiaries.
10.1	Peoples Financial Services Corp. 2017 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 of registrant's current report on Form 8-K filed with the SEC on May 23, 2017)*
10.2	Form of Restricted Stock or Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.2 to Pensco's registration statement on Form S-8 (File No. 333-166886) filed with the SEC on May 17, 2010)*
10.3	Form of Stock Option and/or Appreciation Right Award Agreement (incorporated by reference to Exhibit 10.3 to Pensco's registration statement on Form S-8 (File No. 333-166886) filed with the SEC on May 17, 2010)*
10.4	Form of Performance Award Agreement (incorporated by reference to Exhibit 10.4 to Pensco's registration statement on Form S-8 (File No. 333-166886) filed with the SEC on May 17, 2010)*
10.5	Peoples Security Bank and Trust Company Employee Stock Ownership Plan, amended and restated as of January 1, 2015 (incorporated by reference to Exhibit 10.1 to registrant's quarterly report on Form 10-Q filed with the SEC on May 5, 2017)*
10.6	2016 Compliance Amendment to the Peoples Security Bank and Trust Company Employee Stock Ownership Plan.
10.7	Amendment #2 to the Peoples Security Bank and Trust Company Employee Stock Ownership Plan.
10.8	Peoples Security Bank and Trust Company Executive Cash Bonus Plan, amended and restated as of May 8, 2020 (Incorporated by reference to Exhibit 10.1 attached to the registrant's current report on Form 8-K filed with the Commission on May 12, 2020)
10.9	Penn Security Bank & Trust Company Executive Deferred Compensation Plan (incorporated by reference to Exhibit 10.6 to the annual report of Pensco Financial Services Corp. on Form 10-K filed with the SEC on March 14, 2011)*
10.10	Employment Agreement, dated January 3, 2011, among Pensco Financial Services Corporation, Penn Security Bank & Trust, and Craig W. Best (incorporated by reference to Exhibit 10.1 of the current report of Pensco Financial Services Corp. on Form 8-K filed with the SEC on January 7, 2011)*
10.11	First Amendment to Employment Agreement dated December 31, 2015, by and among Peoples Financial Services Corp., Peoples Security Bank and Trust Company and Craig W. Best (incorporated by reference to Exhibit 10.1 of the current report of Pensco Financial Services Corp. on Form 8-K filed with the SEC on January 6, 2016)*
10.12	Amended and Restated Deferred Compensation Plan #2, dated April 22, 2014, by and between Peoples Security Bank and Trust Company and Craig W. Best (incorporated by reference to Exhibit 10.1 to the registrant's Form 8-K filed with the Commission on April 28, 2014)*
10.13	First Amendment to Amended and Restated Deferred Compensation Plan #2, dated August 29, 2015, by and between Peoples Security Bank and Trust Company and Craig Best (incorporated by reference to Exhibit 10.1 to the registrant's Form 8-K filed with the Commission on September 3, 2015)*
10.14	Second Amendment to Amended and Restated Deferred Compensation Plan #2, dated January 30, 2020, by and between Peoples Security Bank and Trust and Craig Best (incorporated by reference to Exhibit 10.01 to the registrant's Form 8-K filed with the Commission on January 31, 2020)*
10.15	Penn Security Bank & Trust Company Excess Benefit Plan, amended and restated December 31, 2008 (incorporated by reference to Exhibit 10.9 to the annual report of Pensco Financial Services Corp. on Form 10-K filed with the SEC on March 14, 2011)*

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
10.16	Employment Agreement, dated May 30, 2012, among Pensco Financial Services Corporation, Penn Security Bank and Trust Company, and Thomas P. Tulaney (incorporated by reference to Exhibit 10.1 of the Registrant's quarterly report on Form 10-Q filed with the SEC on August 9, 2012)*
10.17	Supplemental Executive Retirement Plan Agreement, dated May 31, 2012, by and among Penn Security Bank and Trust Company, Pensco Financial Services Corporation, and Thomas P. Tulaney (incorporated by reference to Exhibit 10.2 to the Registrant's quarterly report on Form 10-Q filed with the SEC on August 9, 2012)*
10.18	Employment Agreement, dated as of August 27, 2014, by and between Peoples Bank and Neal D. Koplin (incorporated by reference to Exhibit 10.32 to the registrant's Form 10-K filed with the Commission on March 16, 2015)*
10.19	Supplemental Executive Retirement Plan Agreement, dated April 24, 2017, by and among Peoples Security Bank and Trust Company, Peoples Financial Services Corp. and Neal D. Koplin (incorporated by reference to Exhibit 10.1 to registrant's current report on Form 8-K filed with the Commission on April 25, 2017.)*
10.20	Form of Supplemental Director Retirement Plan Agreement for Non-employee Directors (incorporated by reference to Exhibit 10.7 to the registrant's Form 10-K filed with the Commission on March 15, 2005) *
10.21	Form of Amendment to Supplemental Director Retirement Plan Agreement for Non-employee Directors (incorporated by reference to Exhibit 10.10 to the registrant's Form 10-K filed with the Commission on March 15, 2006)*
10.22	Life Insurance Plan for all Non-employee Directors (incorporated by reference to Exhibit 10.21 to the registrant's Form 10-K filed with the Commission on March 15, 2012)*
10.23	Employment Agreement dated as of September 30, 2016 between Peoples Security Bank and Trust Company and Timothy H. Kirtley (incorporated by reference to Exhibit 10.1 to the registrant's quarterly report on Form 10-Q filed with the Commission on November 7, 2016)*
10.24	First Amendment to Employment Agreement dated as of December 5, 2017, by and between Peoples Security Bank and Trust Company and Timothy H. Kirtley(incorporated by reference to Exhibit 10.28 to the registrant's annual report on Form 10-K filed with the Commission on March 14, 2018)*
10.25	Second Amendment to Employment Agreement among Peoples Security Bank and Trust Company, Peoples Financial Services Corp. and Timothy H. Kirtley (Incorporated by reference to Exhibit 10.1 to registrant's quarterly report on Form 10-Q filed with the Commission on August 10, 2020)
10.26	Change in Control Severance Agreement, dated as of January 5, 2021, by and between Peoples Security Bank and Trust Company and John R. Anderson, III (Incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K filed with the Commission on January 8, 2021)
21.1	List of Subsidiaries
23.1	Consent of Baker Tilly US, LLP
24.1	Power of Attorney (Included as part of signature page)
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer of Registrant
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer of Registrant
32.1	Section 1350 Certifications of the Principal Executive Officer and Principal Financial Officer of Registrant
101.INS	Inline XBRL Instance Document
101.SCH	Inline XBRL Taxonomy Extension Schema
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)
*	- Management contract or compensatory plan or arrangement



## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Peoples Financial Services Corp.

By: /s/ Craig W. Best

Craig W. Best  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ John R. Anderson III

John R. Anderson III  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints each of Craig W. Best and John R. Anderson III as his attorney-in-fact, with the full power of substitution, for him in any and all capacities, to sign any amendments to this report, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<i>Name</i>	<i>Title</i>	<i>Date</i>
<u>/s/ William E. Aubrey II</u> William E. Aubrey II	Director and Chairman of the Board	March 16, 2022
<u>/s/ Craig W. Best</u> Craig W. Best	Director and Chief Executive Officer (Principal Executive Officer)	March 16, 2022
<u>/s/ John R. Anderson III</u> John R. Anderson III	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 16, 2022
<u>/s/ Sandra L. Bodnyk</u> Sandra L. Bodnyk	Director	March 16, 2022
<u>/s/ Ronald G. Kukuchka</u> Ronald G. Kukuchka	Director	March 16, 2022

<i>Name</i>	<i>Title</i>	<i>Date</i>
<u>/s/ Richard S. Lochen, Jr.</u> Richard S. Lochen, Jr.	Director	March 16, 2022
<u>/s/ James B. Nicholas</u> James B. Nicholas	Director	March 16, 2022
<u>/s/ Joseph T. Wright, Jr.</u> Joseph T. Wright, Jr.	Director	March 16, 2022