CASS INFORMATION SYSTEMS INC
Form 10-K
March 08, 2017

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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, 2016

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 000-20827

CASS INFORMATION SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Missouri	43-1265338
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
12444 Powerscourt Drive, Suite 550, St. Louis, Missouri 63131	(314) 506-5500
(Address of principal executive offices) (Zip Code)	(Telephone Number, incl. area code)

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

Title of each Class	Name of each exchange on which registered
Common Stock, par value $.50	The Nasdaq Global Select Market

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. Large accelerated filer: Accelerated filer: Non-accelerated filer: Smaller reporting company:

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the common stock held by non-affiliates of the Registrant was approximately $548,000,000 based on the closing price of the common stock of $51.70 on June 30, 2016, as reported by The Nasdaq Global Select Market. As of March 1, 2016, the Registrant had 11,197,226 shares outstanding of common stock.

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DOCUMENTS INCORPORATED BY REFERENCE

Certain information required for Part III of this report is incorporated by reference to the Registrant s Proxy Statement for the 2017 Annual Meeting of Shareholders.

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Forward-looking Statements - Factors That May Affect Future Results

This report may contain or incorporate by reference forward-looking statements made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Although we believe that, in making any such statements, our expectations are based on reasonable assumptions, forward-looking statements are not guarantees of future performance and involve risks, uncertainties, and other factors beyond our control, which may cause future performance to be materially different from expected performance summarized in the forward-looking statements. These risks, uncertainties and other factors are discussed in the section Part I, Item 1A, Risk Factors. We undertake no obligation to publicly update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, or changes to future results over time.

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PART I.

ITEM 1. BUSINESS

Description of Business

Cass Information Systems, Inc. (Cass or the Company) is a leading provider of payment and information processing services to large manufacturing, distribution and retail enterprises across the United States. The Company provides transportation invoice rating, payment processing, auditing, accounting and transportation information to many of the nation s largest companies. It is also a processor and payer of energy invoices, including electricity, gas, waste, and other facility related expenses. Additionally, Cass competes in the telecommunications expense management market which includes bill processing, audit and payment services for telephone, data line, wireless and communication equipment expense. The Company, through its wholly owned bank subsidiary, Cass Commercial Bank (the Bank), also provides commercial banking services. The Bank s primary focus is to support the Company s payment operations and provide banking services to its target markets, which include privately-owned businesses and churches and church-related ministries. Services include commercial and commercial real estate loans, checking, savings and time deposit accounts and other cash management services.

Company Strategy and Core Competencies

Cass is an information services company with a primary focus on processing payables and payables-related transactions for large corporations located in the United States. Cass possesses four core competencies that encompass most of its processing services.

Data acquisition This refers to the gathering of data elements from diverse, heterogeneous sources and the building of complete databases for our customers. Data is the raw material of the information economy. Cass gathers vital data from complex and diverse input documents, electronic media, proprietary databases and data feeds, including data acquired from vendor invoices as well as customer procurement and sales systems. Through its numerous methods of obtaining streams and pieces of raw data, Cass is able to assemble vital data into centralized data management systems and warehouses, thus producing an engine to create the power of information for managing critical corporate functions and processing systems.

Data management Once data is assembled, Cass is able to utilize the power from derived information to produce significant savings and benefits for its clients. This information is integrated into customers unique financial and accounting systems, eliminating the need for internal accounting processing and providing internal and external support for these critical systems. Information is also used to produce management and exception reporting for operational control, feedback, planning assistance and performance measurement.

Business Intelligence Receiving information in the right place at the right time and in the required format is paramount for business survival. Cass information delivery solutions provide reports, digital images, data files and retrieval capabilities through the Internet or directly into customer internal systems. Cass proprietary Internet management delivery system is the foundation for driving these critical functions. Transaction, operational, control, status and processing exception information are all delivered through this system creating an efficient, accessible and highly reliable asset for Cass customers.

Financial exchange Since Cass is unique among its competition in that it owns a commercial bank, it is also able to manage the movement of funds from its customers to their suppliers. This is a distinguishing factor, which clearly requires the processing capability, operating systems and financial integrity of a banking organization. Cass provides immediate, accurate, controlled and protected funds management and transfer system capabilities for all of its customers. Old and costly check processing and delivery mechanisms are replaced with more efficient electronic cash management and funds transfer systems.

Cass core competencies allow it to perform the highest volumes of transaction processing in an integrated, efficient and systematic approach. Not only is Cass able to process the transaction, it is also able to collect the data defining the transaction and effect the financial payment governing its terms.

These core competencies, enhanced through shared business processes, drive Cass strategic business units. Building upon these foundations, Cass continues to explore new business opportunities that leverage these competencies and processes.

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Marketing, Customers and Competition

The Company, through its Transportation Information Services business unit, is one of the largest firms in the transportation bill processing and payment industry in the United States based on the total dollars of transportation bills paid and items processed. Competition consists of a few primary competitors and numerous small transportation bill audit firms located throughout the United States. While offering transportation payment services, few of these audit firms compete on a national basis. These competitors compete mainly on price, functionality and service levels. The Company, through its Expense Management business unit, also competes with other companies, located throughout the United States, that pay energy and waste bills and provide management reporting. Available data indicates that the Company is one of the largest providers of energy information processing and payment services. Cass is unique among these competitors in that it is not exclusively affiliated with any one energy service provider (ESP). The ESPs market the Company s services adding value with their unique auditing, consulting and technological capabilities. Many of Cass services are customized for the ESPs, providing a full-featured solution without any development costs to the ESP. Also the Company, through its Telecom Information Services business unit, is a leader in the growing telecom expense management market, and competes with other companies located throughout the United States in this market.

The Bank is organized as a Missouri trust company with banking powers and was founded in 1906. The Company is classified as a bank holding corporation due to its ownership of a federally-insured commercial bank and was originally organized in 1982 as Cass Commercial Corporation under the laws of Missouri. Approval by the Board of Governors of the Federal Reserve System was received in February 1983. The Company changed its name to Cass Information Systems, Inc. in January 2001. In December 2011, the Federal Reserve Bank (FRB) of St. Louis approved the election of Cass Information Systems, Inc. to become a financial holding company. As a financial holding company, Cass may engage in activities that are financial in nature or incidental to a financial activity. The Bank encounters competition from numerous banks and financial institutions located throughout the St. Louis, Missouri metropolitan area and other areas in which the Bank competes. The Bank s principal competitors, however, are large bank holding companies that are able to offer a wide range of banking and related services through extensive branch networks. The Bank targets its services to privately held businesses located in the St. Louis, Missouri area and church and church-related institutions located in St. Louis, Missouri, Orange County, California, Colorado Springs, Colorado, and other selected cities located throughout the United States.

The Company holds several trademarks for the payment and rating services it provides. These include: FreightPay®, Transdata®, Ratemaker®, Best Rate®, Rate Exchange®, CassPort®, Expense$mart®, WasteVision and Direct2Carrier Payments . The Company and its subsidiaries are not dependent on any one customer for a significant portion of their businesses. The Company and its subsidiaries have a varied client base with no individual client exceeding 10% of total revenue.

Employees

The Company and its subsidiaries had 790 full-time and 285 part-time employees as of March 3, 2017. Of these employees, the Bank had 52 full-time and no part-time employees.

Supervision and Regulation

The Company and its bank subsidiary are extensively regulated under federal and state law. These laws and regulations are intended to primarily protect depositors, not shareholders. The Bank is subject to regulation and supervision by the Missouri Division of Finance, the FRB and the Federal Deposit Insurance Corporation (the FDIC). The Company is a financial holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the BHC Act), and as such, it is subject to regulation, supervision and examination by the FRB. Significant elements of the laws and regulations applicable to the Company and the Bank are described below. The description is qualified in its entirety by reference to the full text of the statutes, regulations and policies that are described. Also, such statutes, regulations and policies are continually under review by Congress and state legislatures and federal and state regulatory agencies. A change in statutes, regulations or regulatory policies applicable to the Company and its subsidiaries could have a material effect on the business, financial condition and results of operations of the Company.

Bank Holding Company Activities In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other related activities. In addition, bank holding companies that qualify and elect to be financial holding companies such as the Company, may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. Such permitted activities include securities underwriting and dealing, insurance underwriting and making merchant banking investments.

To maintain financial holding company status, a financial holding company and all of its depository institution subsidiaries must be well capitalized and well managed. A depository institution subsidiary is considered to be well capitalized if it satisfies the requirements for this status discussed in the section Prompt Corrective Action below. A depository institution subsidiary is considered well managed if it received a composite rating and management rating of at least satisfactory in its most recent examination. A financial holding company s status will also depend upon it maintaining its status as well capitalized and well managed under applicable FRB regulations. If a financial holding company ceases to meet these capital and management requirements, the FRB may impose limitations or conditions on the conduct of its activities during the non-compliance period, and the company may not commence any of the broader financial activities permissible for financial holding companies or acquire a company engaged in such financial activities without prior approval of the FRB. If the company does not return to compliance within 180 days, the FRB may require divestiture of the holding company s depository institutions.

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In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire a company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least satisfactory in its most recent examination under the Community Reinvestment Act. See Community Reinvestment Act below.

The FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or such ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

The BHC Act, the Bank Merger Act, and other federal and state statutes regulate acquisitions of banks and banking companies. The BHC Act requires the prior approval of the FRB for the direct or indirect acquisition by the Company of more than 5% of the voting shares or substantially all of the assets of a bank or bank holding company. Under the Bank Merger Act, the prior approval of the FRB or other appropriate bank regulatory authority is required for the Bank to merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing acquisition applications, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant s performance record under the Community Reinvestment Act and fair housing laws.

The Dodd-Frank Act The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), enacted in July 2010, significantly restructured the financial regulatory environment in the United States, affecting all bank holding companies and banks, including the Company and the Bank, some of which are described in more detail below. The scope and impact of many of the Dodd-Frank Act s provisions will be determined over time as regulations are issued and become effective. As a result, the Company cannot predict the ultimate impact of the Dodd-Frank Act on the Company or the Bank at this time, including the extent to which it could increase costs or restrict the ability to pursue business opportunities, or otherwise adversely affect the Company s business, financial condition and results of operations. However, at a minimum, the Company expects that the regulations enacted under the Dodd-Frank Act will increase operating and compliance costs.

Dividends Both the Company and the Bank are subject to various regulations that restrict their ability to pay dividends and the amount of dividends that they may pay. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), a depository institution, such as the Bank, may not pay dividends if payment would cause it to become undercapitalized or if it is already undercapitalized. The payment of dividends by the Company and the Bank may also be affected or limited by other factors, such as the requirement to maintain adequate capital and, under certain circumstances, the ability of federal regulators to prohibit dividend payments as an unsound or unsafe practice.

Capital Requirements As a bank holding company, the Company and the Bank are subject to capital requirements pursuant to the FRB s capital guidelines which include (i) risk-based capital guidelines, which are designed to make capital requirements more sensitive to various risk profiles and account for off-balance sheet exposure; (ii) guidelines that consider market risk, which is the risk of loss due to change in value of assets and liabilities due to changes in interest rates; and (iii) guidelines that use a leverage ratio which places a constraint on the maximum degree of risk to which a financial holding company may leverage its equity capital base.

Effective July 2, 2013, the FRB approved final rules known as the Basel III Capital Rules that substantially revised the risk-based capital and leverage capital requirements applicable to bank holding companies and depository institutions, including the Company and the Bank. The Basel III Capital Rules implement aspects of the Basel III capital framework agreed upon by the Basel Committee and incorporate changes required by the Dodd-Frank Act. The Basel III Capital Rules came into effect for the Company and the Bank on January 1, 2015 (subject to a phase-in period).

The Basel III Capital Rules require FDIC insured depository institutions to meet and maintain several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio of 4.5%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8.0%, and a 4.0% Tier 1 capital to total assets leverage ratio.

Common equity Tier 1 capital is generally defined as common stockholders equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and Additional Tier 1 capital. Additional Tier 1 capital generally includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus Additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus meeting specified requirements. Also included in Tier 2 capital is the allowance for loan losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions like Cass, that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income (AOCI), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. The calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

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In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, all assets, including certain off-balance sheet assets are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien one to four-family residential mortgages, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans, and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors.

In addition to establishing the minimum regulatory capital requirements, the Basel III Capital Rules limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a capital conservation buffer consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement is being phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increasing by that amount each subsequent January 1 until fully implemented at 2.5% on January 1, 2019.

The FRB has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution s capital level is or may become inadequate in light of the particular risks or circumstances. As of December 31, 2016, the Company and the Bank met all capital adequacy requirements under the Basel III Capital Rules.

Source of Strength Doctrine FRB and other regulations require bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. Under this requirement, the Company is expected to commit resources to support the Bank. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to depositors and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Deposit Insurance Substantially all of the deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the FDIC, and the Bank is subject to deposit insurance assessments to maintain the DIF. Deposit insurance assessments are based on average consolidated total assets minus average tangible equity. Under the FDIC s risk-based assessment system, insured institutions with less than $10 billion in assets, such as the Bank, are assigned to one of four risk categories based on supervisory evaluations, regulatory capital level, and certain other factors, with less risky institutions paying lower assessments. An institution s assessment rate depends upon the category to which it is assigned and certain other factors.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the DIF reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. At least semi-annually, the FDIC will update its loss and income projections for the fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required. FDIC insurance expense totaled approximately $309,700, $349,200 and $332,600 for the years ended December 31, 2016, 2015 and 2014, respectively.

The FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Prompt Corrective Action The Basel III Capital Rules incorporate new requirements into the prompt correction action framework, described above. The Federal Deposit Insurance Act (FDIA) requires that federal banking agencies take prompt corrective action against depository institutions that do not meet minimum capital requirements and includes the following five capital tiers: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A depository institution s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation.

A depository institution is deemed to be (i) well-capitalized if the institution has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 8% or greater, a leverage ratio of 5% or greater, a common equity Tier 1 ratio of 6.5% or greater and is not subject to any regulatory order agreement or written directive to meet and maintain a specific capital level for any capital measure; (ii) adequately capitalized if the institution has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 6% or greater, a leverage ratio of 4% or greater, a common equity Tier 1 ratio of 4.5% or greater and does not meet the definition of well capitalized ; (iii) undercapitalized if the institution has a total risk-based capital ratio that is less than 8%, a Tier 1 risk-based capital ratio of less than 6%, a leverage ratio of less than 4% or a common equity Tier 1 ratio of less than 4.5%; (iv) significantly undercapitalized if the institution has a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 4%, a leverage ratio of less than 3% or a common equity Tier 1 ratio of less than 3%; and (v) critically undercapitalized if the institution has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%. An institution may be deemed to be in a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank s overall financial condition or prospects for other purposes.

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Subject to a narrow exception, a receiver or conservator is required to be appointed for an institution that is critically undercapitalized within specified time frames. The regulations also provide that a capital restoration plan must be filed with the FRB within 45 days of the date an institution is deemed to have received notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Compliance with the plan must be guaranteed by any parent holding company up to the lesser of 5% of the institution s total assets when it was deemed to be undercapitalized or the amount necessary to achieve compliance with applicable capital requirements. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The FRB could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. Significantly and critically undercapitalized institutions are subject to additional mandatory and discretionary measures.

As of December 31, 2016, the most recent notification from the regulatory agencies categorized the Company and the Bank as well-capitalized. For further information regarding the capital ratios and leverage ratio of the Company and the Bank, see Item 8, Note 2 of this report.

Safety and Soundness Regulations In accordance with the FDIA, the federal banking agencies adopted guidelines establishing general standards relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, compensation, fees and benefits. In general, the guidelines require that institutions maintain appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, regulations adopted by the federal banking agencies authorize the agencies to require that an institution that has been given notice that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If the institution fails to submit an acceptable compliance plan or fails in any material respect to implement an accepted compliance plan, the agency must issue an order directing corrective actions and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the prompt corrective action provisions of FDIA. If the institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Loans-to-One-Borrower The Bank generally may not make loans or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, up to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2016, the Bank was in compliance with the loans-to-one-borrower limitations.

Depositor Preference The FDIA provides that, in the event of the liquidation or other resolution of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including depositors whose deposits are payable only outside of the United States and the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

Community Reinvestment Act The Community Reinvestment Act of 1977 (CRA) requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings that must be publicly disclosed. In order for a financial holding company to commence any new activity permitted by the BHC Act, or to acquire any company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least satisfactory in its most recent examination under the CRA. The Bank received a rating of satisfactory in its most recent CRA exam.

Financial Privacy Banks and other financial institutions are subject to regulations that limit their ability to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

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The Bank is also subject to regulatory guidelines establishing standards for safeguarding customer information and maintaining information security programs. The standards set forth in the guidelines are intended to ensure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of such records and protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer.

Transactions with Affiliates Transactions between the Bank and its affiliates are subject to regulations that limit the types and amounts of covered transactions engaged in by the Bank and generally require those transactions to be on an arm s-length basis. The term affiliate is defined to mean any company that controls or is under common control with the Bank and includes the Company and its non-bank subsidiaries. Covered transactions include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, certain purchases of assets from the affiliate, certain derivative transactions that create a credit exposure to an affiliate, the acceptance of securities issued by the affiliate as collateral for a loan, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. In general, these regulations require that any such transaction by the Bank (or its subsidiaries) with an affiliate must be secured by designated amounts of specified collateral and must be limited to certain thresholds on an individual and aggregate basis.

Federal law also limits the Bank s authority to extend credit to its directors, executive officers and 10% shareholders, as well as to entities controlled by such persons. Among other things, extensions of credit to insiders are required to be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons. Also, the terms of such extensions of credit may not involve more than the normal risk of repayment or present other unfavorable features and may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank s capital.

Federal Reserve System FRB regulations require depository institutions to maintain cash reserves against their transaction accounts (primarily NOW and demand deposit accounts). A reserve of 3% is to be maintained against aggregate transaction accounts between $15.2 million and $110.2 million (subject to adjustment by the FRB) plus a reserve of 10% (subject to adjustment by the FRB between 8% and 14%) against that portion of total transaction accounts in excess of $110.2 million. The first $15.2 million of otherwise reservable balances (subject to adjustment by the FRB) is exempt from the reserve requirements. The Bank is in compliance with the foregoing requirements.

Other Regulations The operations of the Company and the Bank are also subject to:

Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Fair Credit Reporting Act, governing the provision of consumer information to credit reporting agencies and the use of consumer information;

Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

Electronic Funds Transfer Act, governing automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one- to four-family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Check Clearing for the 21st Century Act (also known as Check 21), which gives substitute checks, such as digital check images and copies made from that image, the same legal standing as the original paper check; and

The USA PATRIOT Act, which requires banks and savings institutions to establish broadened anti-money laundering compliance programs and due diligence policies and controls to ensure the detection and reporting of money laundering.

The Bank Secrecy Act, which requires U.S. financial institutions to collaborate with the U.S. government in cases of suspected money laundering and fraud.

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Website Availability of SEC Reports

Cass files annual, quarterly and current reports with the Securities and Exchange Commission (the SEC). Cass will, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC, make available free of charge on its website each of its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports, and its definitive proxy statements. The address of Cass website is: www.cassinfo.com. All reports filed with the SEC are available for reading and copying at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549-2736 or for more information call the Public Reference Room at 1-800-SEC-0330. The SEC also makes all filed reports, proxy statements and information statements available on its website at www.sec.gov.

The reference to the Company s website address does not constitute incorporation by reference of the information contained on the website and should not be considered part of this report.

Financial Information about Segments

The services provided by the Company are classified in two reportable segments: Information Services and Banking Services. The revenues from external customers, net income and total assets by segment as of and for each of the years in the three-year period ended December 31, 2016, are set forth in Item 8, Note 16 of this report.

Statistical Disclosure by Bank Holding Companies

For the statistical disclosure by bank holding companies, refer to Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 1A. RISK FACTORS

This section highlights specific risks that could affect the Company s business. Although this section attempts to highlight key factors, please be aware that other risks may prove to be important in the future. New risks may emerge at any time, and Cass cannot predict such risks or estimate the extent to which they may affect the Company s financial performance. In addition to the factors discussed elsewhere or incorporated by reference in this report, the identified risks that could cause actual results to differ materially include the following:

General political, economic or industry conditions may be less favorable than expected.

Local, domestic, and international economic, political and industry-specific conditions and governmental monetary and fiscal policies affect the industries in which the Company competes, directly and indirectly. Conditions such as inflation, recession, unemployment, volatile interest rates, tight money supply, real estate values, international conflicts and other factors outside of Cass control may adversely affect the Company. Economic downturns could result in the delinquency of outstanding loans, which could have a material adverse impact on Cass earnings.

Unfavorable developments concerning customer credit quality could affect Cass financial results.

Although the Company regularly reviews credit exposure related to its customers and various industry sectors in which it has business relationships, default risk may arise from events or circumstances that are difficult to detect or foresee. Under such circumstances, the Company could experience an increase in the level of provision for credit losses, delinquencies, nonperforming assets, net charge-offs and allowance for credit losses.

The Company has lending concentrations, including, but not limited to, churches and church-related entities located in selected cities and privately-held businesses located in or near St. Louis, Missouri, that could suffer a significant decline which could adversely affect the Company.

Cass customer base consists, in part, of lending concentrations in several segments and geographical areas. If any of these segments or areas is significantly affected by weak economic conditions, the Company could experience increased credit losses, and its business could be adversely affected.

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Fluctuations in interest rates could affect Cass net interest income and balance sheet.

The operations of financial institutions such as the Company are dependent to a large degree on net interest income, which is the difference between interest income from loans and investments and interest expense on deposits and borrowings. Prevailing economic conditions, the fiscal and monetary policies of the federal government and the policies of various regulatory agencies all affect market rates of interest, which in turn significantly affect financial institutions net interest income. Fluctuations in interest rates affect Cass financial statements, as they do for all financial institutions. Volatility in interest rates can also result in disintermediation, which is the flow of funds away from financial institutions into direct investments, such as federal government and corporate securities and other investment vehicles, which, because of the absence of federal insurance premiums and reserve requirements, generally pay higher rates of return than financial institutions. As discussed in greater detail in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, a continuation of the current low level of interest rates would have a negative impact on the Company s net interest income.

Operational difficulties or cyber-security problems could damage Cass reputation and business.

In the ordinary course of business, the Company depends on the reliable operation of its computer operations and network connections from its clients to its systems. Any failure, interruption, or breach in security of these systems would cause Cass to be unable to process transactions for its clients, resulting in decreased revenues. Additionally, any failure, interruption, breach in security or loss of data, whatever the cause, could reduce client satisfaction with the Company s products and services and harm Cass financial results. These types of threats may derive from human error, fraud or malice on the part of external or internal parties, or may result from accidental technological failure. Further, to access the Company s products and services, Cass customers may use computers and mobile devices that are beyond the Company s security control systems. The Company s technologies, systems, networks and software, and those of other financial institutions have been, and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at Cass. The risk of a security breach or disruption, particularly through cyber-attack or cyber intrusion, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased. A material security problem affecting Cass could damage its reputation, deter prospects from purchasing its products and services, deter customers from using its products and services or result in liability to Cass.

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

Cass must respond to rapid technological changes and these changes may be more difficult or expensive than anticipated.

If competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, the Company s existing product and service offerings, technology and systems may become obsolete. Further, if Cass fails to adopt or develop new technologies or to adapt its products and services to emerging industry standards, Cass may lose current and future customers. Finally, Cass ability to adopt these technologies can also be inhibited by intellectual property rights of third parties. Any of these could have a material adverse effect on its business, financial condition and results of operations. The payment processing and financial services industries are changing rapidly and in order to remain competitive, Cass must continue to enhance and improve the functionality and features of its products, services and technologies. These changes may be more difficult or expensive than the Company anticipates.

Operations of the Company s customer base are impacted by macro-economic factors such as a strong dollar and/or volatility in commodity prices. A reduction in its customers operations could have a material adverse effect on Cass results of operations.

The recent decline in the cost of oil worldwide has had a negative effect on both the number of freight transactions processed and the dollar amount of invoices processed. For example, lower oil prices have caused a significant drop in drilling supplies being transported to fracking operations by domestic railroads and trucks, as U.S. oil prices are no longer as competitive with the prices of imported oil. Lower oil prices have also resulted in lower gas and fuel prices, negatively affecting the dollar amounts of the invoices that Cass processes for its freight and shipping customers. A further decline in oil prices would continue to have an adverse effect on the Company s revenues and could significantly impact its results of operations.

Methods of reducing risk exposures might not be effective.

Instruments, systems and strategies used to hedge or otherwise manage exposure to various types of credit, interest rate, market and liquidity, operational, regulatory/compliance, business risks and enterprise-wide risks could be less effective than anticipated. As a result, the Company may not be able to effectively mitigate its risk exposures in particular market environments or against particular types of risk.

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Customer borrowing, repayment, investment, deposit, and payable processing practices may be different than anticipated.

The Company uses a variety of financial tools, models and other methods to anticipate customer behavior as part of its strategic and financial planning and to meet certain regulatory requirements. Individual, economic, political and industry-specific conditions and other factors outside of Cass control could alter predicted customer borrowing, repayment, investment, deposit, and payable processing practices. Such a change in these practices could adversely affect Cass ability to anticipate business needs, including cash flow and its impact on liquidity, and to meet regulatory requirements.

Cass stock price can become volatile and fluctuate widely in response to a variety of factors.

The Company s stock price can fluctuate based on factors that can include actual or anticipated variations in Cass quarterly results; new technology or services by competitors; unanticipated losses or gains due to unexpected events, including losses or gains on securities held for investment purposes; significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving the Company or its competitors; changes in accounting policies or practices; failure to integrate acquisitions or realize anticipated benefits from acquisitions; or changes in government regulations.

General market fluctuations, industry factors and general economic and political conditions, such as economic slowdowns or recessions, governmental intervention, interest rate changes, credit loss trends, low trading volume or currency fluctuations also could cause Cass stock price to decrease regardless of the Company s operating results.

Competitive product and pricing pressure within Cass markets may change.

The Company operates in a very competitive environment, which is characterized by competition from a number of other vendors and financial institutions in each market in which it operates. The Company competes with large payment processors and national and regional financial institutions and also smaller auditing companies and banks in terms of products and pricing. If the Company is unable to compete effectively in products and pricing in its markets, business could decline.

Management s ability to maintain and expand customer relationships may differ from expectations.

The industries in which the Company operates are very competitive. The Company not only competes for business opportunities with new customers, but also competes to maintain and expand the relationships it has with its existing customers. The Company continues to experience pressures to maintain these relationships as its competitors attempt to capture its customers.

The introduction, withdrawal, success and timing of business initiatives and strategies, including, but not limited to, the expansion of payment and processing activities to new markets, the expansion of products and services to existing markets and opening of new bank branches, may be less successful or may be different than anticipated. Such a result could adversely affect Cass business.

The Company makes certain projections as a basis for developing plans and strategies for its payment processing and banking products. If the Company does not accurately determine demand for its products and services, it could result in the Company incurring significant expenses without the anticipated increases in revenue, which could result in an adverse effect on its earnings.

Management s ability to retain key officers and employees may change.

Cass future operating results depend substantially upon the continued service of Cass executive officers and key personnel. Cass future operating results also depend in significant part upon Cass ability to attract and retain qualified management, financial, technical, marketing, sales, and support personnel. Competition for qualified personnel is intense, and the Company cannot ensure success in attracting or retaining qualified personnel. There may be only a limited number of persons with the requisite skills to serve in these positions, and it may be increasingly difficult for the Company to hire personnel over time. Cass business, financial condition and results of operations could be materially adversely affected by the loss of any of its key employees, by the failure of any key employee to perform in his or her current position, or by Cass inability to attract and retain skilled employees.

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Recent legislative and regulatory initiatives to support the financial services industry have been coupled with numerous restrictions and requirements that could detrimentally affect the Company s business.

The Dodd-Frank Act is significantly changing the current bank regulatory structure and affecting the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies.

The Company and the Bank are supervised and regulated primarily by the FRB. In addition, the Company is subject to consolidated capital requirements, made more strict by the recent adoptions and implementation of the Basel III Capital Rules, and must serve as a source of strength to the Bank. It is possible such requirements may limit our capacity to pay dividends or repurchase shares.

The Dodd-Frank Act also broadens the base for FDIC insurance assessments. The FDIC insures deposits at FDIC-insured financial institutions, including the Bank. The FDIC charges insured financial institutions premiums to maintain the DIF at a specific level. The Bank s FDIC insurance premiums increased substantially beginning in 2009, and the Bank expects to pay high premiums in the future. Economic conditions during the recent recession increased bank failures and decreased the DIF. The FDIC may increase the assessment rates or impose additional special assessments in the future to keep the DIF at the statutory target level. Any increase in our FDIC premiums could have an adverse effect on the Bank s profits and financial condition.

The scope and impact of many of the Dodd-Frank Act provisions will be determined over time as regulations are issued and become effective. As a result, the Company cannot predict the ultimate impact of the Dodd-Frank Act at this time, including the extent to which it could increase costs or limit the ability to pursue business opportunities in an efficient manner, or otherwise adversely affect the business, financial condition and results of operations. However, it is expected that at a minimum, any new regulations issued will increase operating and compliance costs.

New capital rules generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

The Dodd-Frank Act requires the federal banking agencies to establish stricter risk-based capital requirements and leverage limits to apply to banks and bank and savings and loan holding companies. In July 2013, the federal banking agencies published the final Basel III Capital Rules that revised their risk-based and leverage capital requirements and their method for calculating risk-weighted assets. The Basel III Capital Rules will apply to banking organizations, including the Company and the Bank. As discussed in Item 1, Business Supervision and Regulation, the Basel III Capital Rules became effective on January 1, 2015 with a phase-in period that generally extends through January 1, 2019. The final rules increase capital requirements and generally include two new capital measurements that will affect the Company a risk-based common equity Tier 1 ratio and a capital conservation buffer. Common equity Tier 1 capital is a subset of Tier 1 capital and is limited to common equity (plus related surplus), retained earnings, accumulated other comprehensive income and certain other items. Other instruments that have historically qualified for Tier 1 treatment, including non-cumulative perpetual preferred stock, are consigned to a category known as Additional Tier 1 capital and must be phased out over a period of nine years beginning in 2014. The rules permit bank holding companies with less than $15 billion in assets (such as the Company) to continue to include trust preferred securities and non-cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not common equity Tier 1 capital. Tier 2 capital consists of instruments that have historically been placed in Tier 2, as well as cumulative perpetual preferred stock.

The final rules adjust all three categories of capital by requiring new deductions from and adjustments to capital that will result in more stringent capital requirements. Beginning January 1, 2015, the minimum capital requirements are (i) a common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio (common equity Tier 1 capital plus Additional Tier 1 capital) of 6%; (iii) a total capital ratio of 8%; and (iv) a leverage ratio of 4%. Beginning in 2016, a capital conservation buffer is being phased in over three years, ultimately resulting in a requirement of 2.5% on top of the common equity Tier 1, Tier 1 and total capital requirements, resulting in a required common equity Tier 1 capital ratio of 7%, a Tier 1 capital ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions.

In addition to the higher required capital ratios and the new deductions and adjustments, the final rules increase the risk weights for certain assets, meaning that the Company will have to hold more capital against these assets. For example, commercial real estate loans that do not meet certain new underwriting requirements now must be risk-weighted at 150%, rather than the previous 100%. There are also new risk weights for unsettled transactions and derivatives. There will also be a requirement to hold capital against short-term commitments that are not unconditionally cancelable (currently, there are no capital requirements for these off-balance sheet assets). All changes to the risk weights took effect in 2015. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in management modifying its business strategy and could limit the ability to make distributions, including paying dividends or buying back shares.

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Cass is subject to extensive regulatory oversight.

The Company is subject to extensive regulation and supervision that is designed primarily for the protection of the DIF and depositors, and not to the benefit of the shareholders. As a result, the Company is limited in the manner in which it conducts business, undertakes new investments and activities and obtains financing. This regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to capital levels, the timing and amount of dividend payments, the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Failure to comply with these and other regulatory requirements can lead to, among other remedies, administrative enforcement actions and other legal proceedings, including the imposition of civil money penalties.

Changes in regulation or oversight may have a material adverse impact on Cass operations.

The Company is subject to extensive regulation, supervision and examination by the Missouri Division of Finance, the FDIC, the FRB, the SEC and other regulatory bodies. Such regulation and supervision governs the activities in which the Company may engage. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on Cass operations, investigations and limitations related to Cass securities, the classification of Cass assets and determination of the level of Cass 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 adverse impact on Cass operations.

Legal and regulatory proceedings and related matters with respect to the financial services industry, including those directly involving the Company and its subsidiaries, could adversely affect Cass or the financial services industry in general.

The Company is subject to various legal and regulatory proceedings. It is inherently difficult to assess the outcome of these matters, and there can be no assurance that the Company will prevail in any proceeding or litigation. Any such matter could result in substantial cost and diversion of Cass efforts, which by itself could have a material adverse effect on Cass financial condition and operating results. Further, adverse determinations in such matters could result in actions by Cass regulators that could materially adversely affect Cass business, financial condition or results of operations. Please refer to Item 3, Legal Proceedings.

The Company s accounting policies and methods are the basis of how Cass reports its financial condition and results of operations, and they require management to make estimates about matters that are inherently uncertain. In addition, changes in accounting policies and practices, as may be adopted by the regulatory agencies, the Financial Accounting Standards Board, or other authoritative bodies, could materially impact Cass financial statements.

The Company s accounting policies and methods are fundamental to how Cass records and reports its financial condition and results of operations. Management must exercise judgment in selecting and applying many of these accounting policies and methods in order to ensure that they comply with generally accepted accounting principles and reflect management s judgment as to the most appropriate manner in which to record and report Cass financial condition and results of operations. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which might be reasonable under the circumstances yet might result in the Company reporting materially different amounts than would have been reported under a different alternative.

Cass has identified three accounting policies as being critical to the presentation of its financial condition and results of operations because they require management to make particularly subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. More information on Cass critical accounting policies is contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

From time to time, the regulatory agencies, the Financial Accounting Standards Board (FASB), and other authoritative bodies change the financial accounting and reporting standards that govern the preparation of the Company s financial statements. These changes can be hard to predict and can materially impact how management records and reports the Company s financial condition and results of operations.

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Cass is subject to examinations and challenges by tax authorities, which, if not resolved in the Company s favor, could adversely affect the Company s financial condition and results of operations.

In the normal course of business, Cass and its affiliates are routinely subject to examinations and challenges from federal and state tax authorities regarding the amount of taxes due in connection with investments it has made and the businesses in which it is engaged. Recently, federal and state taxing authorities have become increasingly aggressive in challenging tax positions taken by financial institutions. These tax positions may relate to tax compliance, sales and use, franchise, gross receipts, payroll, property and income tax issues, including tax base, apportionment and tax credit planning. The challenges made by tax authorities may result in adjustments to the timing or amount of taxable income or deductions or the allocation of income among tax jurisdictions. If any such challenges are made and are not resolved in the Company s favor, they could have an adverse effect on Cass financial condition and results of operations.

There could be terrorist activities or other hostilities, which may adversely affect the general economy, financial and capital markets, specific industries, and the Company.

The terrorist attacks in September 2001 in the United States and ensuing events, as well as the resulting decline in consumer confidence, had a material adverse effect on the economy. Any similar future events may disrupt Cass operations or those of its customers. In addition, these events had and may continue to have an adverse impact on the U.S. and world economy in general and consumer confidence and spending in particular, which could harm Cass operations. Any of these events could increase volatility in the U.S. and world financial markets, which could harm Cass stock price and may limit the capital resources available to its customers and the Company. This could have a significant impact on Cass operating results, revenues and costs and may result in increased volatility in the market price of Cass common stock.

There could be natural disasters, including, but not limited to, hurricanes, tornadoes, earthquakes, fires and floods, which may adversely affect the general economy, financial and capital markets, specific industries, and the Company.

The Company has significant operations and customer base in Missouri, California, Ohio, Massachusetts, South Carolina, Kansas, Florida, Colorado and other regions where natural disasters may occur. These regions are known for being vulnerable to natural disasters and other risks, such as tornadoes, hurricanes, earthquakes, fires and floods. These types of natural disasters at times have disrupted the local economy, Cass business and customers and have posed physical risks to Cass property. A significant natural disaster could materially affect Cass operating results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

In September 2012, the Company entered into a 10-year lease for office space in St. Louis County, Missouri, to house the headquarters of the Company and the Bank. The Company s headquarters occupy 13,991 square feet in an office center at 12444 Powerscourt Drive along with 3,563 square feet in the same center at 12412 Powerscourt Drive. The Bank s headquarters occupy 10,564 square feet in the same center at 12412 Powerscourt Drive.

The Company owns approximately 61,500 square feet of office space at 13001 Hollenberg Drive in Bridgeton, Missouri where the Company s transportation processing activities are performed.

The Company owns a production facility of approximately 45,500 square feet located at 2675 Corporate Exchange Drive, Columbus, Ohio. Additional facilities are located in Lowell, Massachusetts, Greenville, South Carolina, Wellington, Kansas, Jacksonville, Florida and Columbus, Ohio. The Company has an office in Breda, Netherlands to service its multinational customers.

In addition, the Bank owns a banking facility near downtown St. Louis, Missouri, has an operating branch in the Bridgeton, Missouri location, and has additional leased facilities in Fenton, Missouri, Santa Ana, California and Colorado Springs, Colorado.

Management believes that these facilities are suitable and adequate for the Company s operations.

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ITEM 3. **LEGAL PROCEEDINGS**

The Company and its subsidiaries are not involved in any pending proceedings other than ordinary routine litigation incidental to their businesses. Management believes none of these proceedings, if determined adversely, would have a material effect on the business or financial conditions of the Company or its subsidiaries.

ITEM 4. **MINE SAFETY DISCLOSURES**

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company s common stock is quoted on The Nasdaq Global Select Market® under the symbol CASS. As of March 3, 2017, there were approximately 2,921 holders of record of the Company s common stock. High and low sale prices, as reported by The Nasdaq Global Select Market for each quarter of 2016 and 2015, were as follows:

	2016		2015	
	High	Low	High	Low
1st Quarter	$ 53.66	$ 47.65	$ 57.54	$ 43.00
2nd Quarter	52.76	45.05	58.25	48.97
3rd Quarter	58.64	49.55	59.09	43.78
4th Quarter	74.83	52.69	54.71	47.40

The Company has continuously paid regularly scheduled cash dividends since 1934 and expects to continue to pay quarterly cash dividends in the future. Cash dividends paid per share by the Company during the two most recent fiscal years were as follows:

	2016	2015
March	$ .220	$ .210
June	.220	.210
September	.220	.210
December	.230	.220

Subsidiary dividends can be a significant source of funds for payment of dividends by the Company to its shareholders. Both the Company and the Bank are subject to various regulations that restrict their ability to pay dividends and the amount of dividends that they may pay. Under the FDICIA, a depository institution, such as the Bank, may not pay dividends if payment would cause it to become undercapitalized or if it is already undercapitalized. The payment of dividends by the Company and the Bank may also be affected or limited by other factors, such as the requirement to maintain adequate capital and, under certain circumstances, the ability of federal regulators to prohibit dividend payments as an unsound or unsafe practice. For further information regarding capital ratios and leverage ratio requirements of the Company and the Bank and the effect on payment of dividends, see Item 8, Note 2 of this report.

The Company repurchased a total of 187,123 shares at an aggregate cost of $9,215,000 during the year ended December 31, 2016 and 216,412 shares at an aggregate cost of $10,591,000 during the year ended December 31, 2015. A portion of the repurchased shares may be used for the Company s employee benefit plans, and the balance will be available for other general corporate purposes. The stock repurchase authorization does not have an expiration date and the pace of repurchase activity will depend on factors such as levels of cash generation from operations, cash requirements for investments, repayment of debt, current stock price, and other factors. The Company may repurchase shares from time to time on the open market or in private transactions, including structured transactions. The stock repurchase program may be modified or discontinued at any time.

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Performance Quoted on The Nasdaq Stock Market for the Last Five Fiscal Years

The following graph compares the cumulative total returns over the last five fiscal years of a hypothetical investment of $100 in shares of common stock of the Company with a hypothetical investment of $100 in The Nasdaq Stock Market (Nasdaq) and in the index of Nasdaq computer and data processing stocks. The graph assumes $100 was invested on December 31, 2011, with dividends reinvested. Returns are based on period end prices.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected financial information for each of the five years ended December 31. The selected financial data should be read in conjunction with the Company s consolidated financial statements and accompanying notes included in Item 8 of this report.

(Dollars in thousands except per share data)	2016	2015	2014	2013	2012
Fee revenue and other income	$ 86,136	$ 83,368	$ 79,907	$ 76,572	$ 71,138
Interest income on loans	29,063	28,669	29,726	32,110	35,525
Interest income on debt and equity securities	9,801	9,498	9,441	8,915	9,938
Other interest income	1,066	543	592	552	470
Total interest income	39,930	38,710	39,759	41,577	45,933
Interest expense on deposits	2,029	2,111	2,460	2,832	3,148
Provision for loan losses	(1,500)	(850)		500	2,400
Net interest income after provision	39,401	37,449	37,299	38,245	40,385
Operating expense	93,473	89,783	85,414	84,086	80,333
Income before income tax expense	32,064	31,034	31,792	30,731	31,190
Income tax expense	7,716	7,978	7,759	7,234	7,887
Net income	$ 24,348	$ 23,056	$ 24,033	$ 23,497	$ 23,303
Diluted earnings per share	$ 2.15	$ 2.00	$ 2.06	$ 2.02	$ 2.02
Dividends per share	.89	.85	.81	.74	.64
Dividend payout ratio	40.98%	42.06%	38.85%	36.21%	31.59%
Average total assets	$ 1,504,474	$ 1,439,511	$ 1,424,967	$ 1,351,782	$ 1,344,492
Average net loans	667,158	659,109	651,984	647,827	671,900
Average investment securities	352,129	330,095	321,836	294,846	313,184
Average total deposits	614,975	579,752	571,039	550,110	541,046
Average total shareholders equity	207,060	197,853	200,149	175,441	167,867
Return on average total assets	1.62%	1.60%	1.69%	1.74%	1.73%
Return on average equity	11.76	11.65	12.01	13.39	13.88
Average equity to assets ratio	13.76	13.74	14.05	12.98	12.49
Equity to assets ratio at year-end	13.82	14.25	13.36	14.36	13.80
Tangible common equity to tangible assets	13.04	13.42	12.52	13.39	12.47
Tangible common equity to risk-weighted assets	20.13	21.19	19.65	20.37	17.98
Net interest margin	3.32	3.38	3.43	3.63	4.00
Allowance for loan losses to loans at year-end	1.53	1.77	1.78	1.79	1.80
Nonperforming assets to loans and foreclosed assets	.04	.48*	.07	.27	1.15*
Net loan (recoveries) charge-offs to average loans outstanding	(.01)	(.09)	(.03)	.18	.44

* In February 2016, one nonaccrual loan with a balance of $2,727,000 was paid in full. The percentage, as adjusted, would have been .06%. In February 2013, a payment of $4,115,000 was received for one nonaccrual loan with a balance of $4,198,000. $83,000 was charged off. The percentage, as adjusted, would have been ..54%.

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

The following discussion and analysis provides information about the financial condition and results of operations of the Company for the years ended December 31, 2016, 2015 and 2014. This discussion and analysis should be read in conjunction with the Company s consolidated financial statements and accompanying notes and other selected financial data presented elsewhere in this report.

Executive Overview

Cass provides payment and information processing services to large manufacturing, distribution and retail enterprises from its offices/locations in St. Louis, Missouri, Columbus, Ohio, Boston, Massachusetts, Greenville, South Carolina, Wellington, Kansas, Jacksonville, Florida, and

Breda, Netherlands. The Company s services include freight invoice rating, payment processing, auditing, and the generation of accounting and transportation information. Cass also processes and pays energy invoices, which include electricity and gas as well as waste and telecommunications expenses, and is a provider of telecom expense management solutions. Cass extracts, stores, and presents information from freight, energy, telecommunication and environmental invoices, assisting its customers transportation, energy, environmental and information technology managers in making decisions that will enable them to improve operating performance. The Company receives data from multiple sources, electronic and otherwise, and processes the data to accomplish the specific operating requirements of its customers. It then provides the data in a central repository for access and archiving. The data is finally transformed into information through the Company s databases that allow client interaction as required and provide Internet-based tools for analytical processing. The Company also, through Cass Commercial Bank, its St. Louis, Missouri-based bank subsidiary, provides banking services in the St. Louis metropolitan area, Orange County, California, Colorado Springs, Colorado, and other selected cities in the United States. In addition to supporting the Company s payment operations, the Bank provides banking services to its target markets, which include privately-owned businesses and churches and church-related ministries.

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The specific payment and information processing services provided to each customer are developed individually to meet each customer s requirements, which can vary greatly. In addition, the degree of automation such as electronic data interchange, imaging, work flow, and web-based solutions varies greatly among customers and industries. These factors combine so that pricing varies greatly among the customer base. In general, however, Cass is compensated for its processing services through service fees and investment of account balances generated during the payment process. The amount, type, and calculation of service fees vary greatly by service offering, but generally follow the volume of transactions processed. Interest income from the balances generated during the payment processing cycle is affected by the amount of time Cass holds the funds prior to payment and the dollar volume processed. Both the number of transactions processed and the dollar volume processed are therefore key metrics followed by management. Other factors will also influence revenue and profitability, such as changes in the general level of interest rates, which have a significant effect on net interest income. The funds generated by these processing activities are invested in overnight investments, investment grade securities, and loans generated by the Bank. The Bank earns most of its revenue from net interest income, or the difference between the interest earned on its loans and investments and the interest paid on its deposits and other borrowings. The Bank also assesses fees on other services such as cash management services.

Industry-wide factors that impact the Company include the willingness of large corporations to outsource key business functions such as freight, energy, telecommunication and environmental payment and audit. The benefits that can be achieved by outsourcing transaction processing, and the management information generated by Cass systems can be influenced by factors such as the competitive pressures within industries to improve profitability, the general level of transportation costs, deregulation of energy costs, and consolidation of telecommunication providers. Economic factors that impact the Company include the general level of economic activity that can affect the volume and size of invoices processed, the ability to hire and retain qualified staff, and the growth and quality of the loan portfolio. The general level of interest rates also has a significant effect on the revenue of the Company. As discussed in greater detail in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, a decline in the general level of interest rates can have a negative impact on net interest income and conversely, a rise in the general level of interest rates can have a positive impact on net interest income. The cost of fuel is another factor that has a significant impact on the transportation sector. As the price of fuel goes up or down, the Company s earnings increase or decrease with the dollar amount of transportation invoices. Another negative impact of low fuel prices was a significant drop in the number of invoices related to drilling supplies carried by domestic railroads and trucks that move pipes, sand and water for fracking operations.

In 2016, total fee revenue and other income increased $2,768,000, or 3%, net interest income after provision for loan losses increased $1,952,000, or 5%, and total operating expenses increased $3,690,000, or 4%. This positive performance in 2016 was attributable to sales growth generated by new customers and broadened service offerings which helped offset the headwinds created by the challenging economic environment plus the receipt of a one-time litigation settlement of $1.4 million ($800,000 reduction in other operating expenses and $600,000 loan loss recovery) in the fourth quarter of 2015. The Company also was able to take advantage of tax benefits related to the continued investment in technology. Gains on sales of investments securities were lower by $2,523,000 in 2016 compared to 2015. The asset quality of the Company s loans and investments as of December 31, 2016 remained strong.

Currently, management views Cass major opportunity as the continued expansion of its payment and information processing service offerings and customer base. Management intends to accomplish this by maintaining the Company s leadership position in applied technology, which when combined with the security and processing controls of the Bank, makes Cass unique in the industry.

Impact of New and Not Yet Adopted Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09 *Revenue from Contracts with Customers*. The ASU supersedes revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification (ASC). The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance identifies specific steps that entities should apply in order to achieve this principle. Under the ASU, the amendments are effective for interim and annual periods beginning January 1, 2018 and must be applied retrospectively. The impact of the adoption of this ASU is currently being evaluated but is not expected to have a material impact on the Company s consolidated financial statements or results of operations.

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In February 2016, the FASB issued ASU No. 2016-02 *Leases (ASC Topic 842)*. The ASU improves financial reporting about leasing transactions. The ASU affects all companies and other organizations that lease assets such as real estate, airplanes, and manufacturing equipment. Consistent with current generally accepted accounting principles (GAAP), the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP which requires only capital leases to be recognized on the balance sheet the new ASU will require both types of leases to be recognized on the balance sheet. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The ASU will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The impact of the adoption of this ASU is currently being evaluated but is not expected to have a material impact on the Company s consolidated financial statements or results of operations.

In March 2016, the FASB issued ASU No. 2016-09 *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The ASU will simplify the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This standard is effective for fiscal periods beginning after December 15, 2016. The impact of the adoption of this ASU is currently being evaluated.

In June 2016, the FASB issued ASU No. 2016-13 - *Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The ASU requires measurement and recognition of expected credit losses for financial assets held. Under this standard, a company will be required to hold an allowance equal to the expected life-of-loan losses on the loan portfolio. The standard is effective for fiscal periods beginning after December 15, 2019. The impact of the adoption of this ASU is currently being evaluated.

Critical Accounting Policies

The Company has prepared the consolidated financial statements in this report in accordance with the FASB ASC. In preparing the consolidated financial statements, management makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. These estimates have been generally accurate in the past, have been consistent and have not required any material changes. There can be no assurances that actual results will not differ from those estimates. Certain accounting policies that require significant management estimates and are deemed critical to the Company s results of operations or financial position have been discussed with the Audit Committee of the Board of Directors and are described below.

Allowance for Loan Losses. The Company performs periodic and systematic detailed reviews of its loan portfolio to assess overall collectability. The level of the allowance for loan losses reflects management s estimate of the collectability of the loan portfolio. Although these estimates are based on established methodologies for determining allowance requirements, actual results can differ significantly from estimated results. These policies affect both segments of the Company. The impact and associated risks related to these policies on the Company s business operations are discussed in the Provision and Allowance for Loan Losses section of this report. The Company s estimates have been materially accurate in the past, and accordingly, the Company expects to continue to utilize the present processes.

Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in addressing the future tax consequences of events that have been recognized in the Company s financial statements or tax returns such as the realization of deferred tax assets or changes in tax laws or interpretations thereof. In addition, the Company is subject to the continuous examination of its income tax returns by the Internal Revenue Service and other taxing authorities. In accordance with FASB ASC 740 - *Income Taxes*, the Company has unrecognized tax benefits related to tax positions taken or expected to be taken. See Item 8, Note 13 to the consolidated financial statements contained herein.

Pension Plans. The amounts recognized in the consolidated financial statements related to pension plans are determined from actuarial valuations. Inherent in these valuations are assumptions, including expected return on plan assets, discount rates at which the liabilities could be settled at December 31, 2016, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Item 8, Note 10 to the consolidated financial statements. Pursuant to FASB ASC 715 - *Compensation Retirement Benefits*, the Company has recognized the funded status of its defined benefit postretirement plan in its balance sheet and has recognized changes in that funded status through comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation as of the date of its fiscal year-end.

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Summary of Results

	For the Years Ended December 31,			% Change	
(In thousands except per share data)	**2016**	**2015**	**2014**	**2016 v. 2015**	**2015 v. 2014**
Total processing volume	57,897	54,521	54,741	6.2%	(0.4)%
Total processing dollars	$ 34,689,268	$ 36,264,188	$ 38,472,500	(4.3)	(5.7)
Payment and processing fees	$ 83,713	$ 78,622	$ 77,427	6.5	1.5
Net interest income after provision for loan losses	$ 39,401	$ 37,449	$ 37,299	5.2	0.4
Total net revenue	$ 125,537	$ 120,817	$ 117,206	3.9	3.1
Average earning assets	$ 1,308,914	$ 1,244,797	$ 1,242,549	5.2	0.2
Net interest margin*	3.32%	3.38%	3.43%		
Net income	$ 24,348	$ 23,056	$ 24,033	5.6	(4.1)
Diluted earnings per share	$ 2.15	$ 2.00	$ 2.06	7.5	(2.9)
Return on average assets	1.62%	1.60%	1.69%		
Return on average equity	11.76%	11.65%	12.01%		

* Presented on a tax-equivalent basis

The results of 2016 compared to 2015 include the following significant items:

Overall, the Company s performance was boosted as a result of adding new accounts and expanding service lines as payment and processing fees and total processing volume increased 7% and 6%, respectively. Lingering adverse economic factors including low interest rates and low energy prices continued to impact total processing dollars, which decreased 4%, and net interest margin. The decrease in processing dollars generated smaller investable balances that lowered investment income and fees from carrier services.

Average earning assets and net interest income after provision for loan losses both increased 5% year over year. The increase in net interest income after provision for loan losses was primarily due to higher average earning assets and a negative provision for loan losses of $1,500,000 in 2016 compared to $850,000 in 2015.

Gains from the sale of securities were $387,000 in 2016 and $2,910,000 in 2015. Bank service fees increased $53,000, or 4%, and other income increased $147,000. Operating expenses increased $3,690,000, or 4%, as the Company invested in staff and technology to win and support new business and the Company received a one-time litigation settlement of $1.4 million ($800,000 reduction in other operating expenses and $600,000 loan loss recovery) in the prior year.

The results of 2015 compared to 2014 include the following significant items:

Overall, the Company s performance was impacted by lingering adverse economic factors including low interest rates, plummeting energy prices and a contraction in U.S. manufacturing output. Total processing dollars fell 6%. The decrease in processing dollars generated smaller investable balances that lowered investment income. The Company received a onetime litigation settlement of $1.4 million ($800,000 reduction in other operating expenses and $600,000 loan loss recovery) in 2015.

Net interest income after provision for loan losses and average earning assets increased very slightly year over year, primarily due to a negative provision for loan losses of $850,000 in the fourth quarter of 2015.

Gains from the sale of securities were $2,910,000 in 2015 and $23,000 in 2014. Bank service fees increased $91,000, or 8%, and other income was down $712,000. Operating expenses increased $4,369,000, or 5%, as the Company incurred higher health insurance costs and retirement plan expenses. Salaries also increased as the Company invested in staff and technology to win and support new business.

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Fee Revenue and Other Income

The Company s fee revenue is derived mainly from transportation and facility payment and processing fees. As the Company provides its processing and payment services, it is compensated by service fees which are typically calculated on a per-item basis, discounts received for services provided to carriers and by the accounts and drafts payable balances generated in the payment process which can be used to generate interest income. Processing volumes, fee revenue and other income were as follows:

	December 31,			% Change	
(In thousands)	**2016**	**2015**	**2014**	**2016 v. 2015**	**2015 v. 2014**
Transportation invoice transaction volume	34,352	33,958	34,141	1.2%	(0.5)%
Transportation invoice dollar volume	$ 22,774,909	$ 24,534,285	$ 25,993,966	(7.2)	(5.6)
Expense management transaction volume*	23,545	20,563	20,600	14.5	(0.2)
Expense management dollar volume*	$ 11,914,359	$ 11,729,903	$ 12,478,534	1.6	(6.0)
Payment and processing revenue	$ 83,713	$ 78,622	$ 77,427	6.5	1.5
Bank service fees	$ 1,276	$ 1,223	$ 1,132	4.3	8.0
Gains on sales of investment securities	$ 387	$ 2,910	$ 23	(86.7)	n.m.
Other	$ 760	$ 613	$ 1,325	24.0	(53.7)

* Includes energy, telecom and environmental

Fee revenue and other income in 2016 compared to 2015 include the following significant pre-tax components:

In the transportation sector, new business and a growing customer base boosted invoice volume, though lingering negative factors continued to hinder dollar volume growth. Reduced average invoice amounts caused by low fuel and carrier prices as well as shifts in modal activity impacted dollar volume. The decrease in dollar volume also generated smaller investable balances that reduced investment income and more significantly lowered fees from carrier services. Expense management transaction volume increased 15% and dollar volume increased 2% as new customer wins, including several large accounts that migrated from competitors, fueled the increase. Gains on sales of investment securities decreased as market conditions were not as favorable in the current year.

Fee revenue and other income in 2015 compared to 2014 include the following significant pre-tax components:

The transportation group added new accounts which produced higher transaction volume, but the benefits of that growth were offset by declining activity from existing customers, especially those involved in oil and gas production, resulting in a decrease of less than 1%. Transportation dollar volume fell 6% as lower fuel prices reduced average invoice amounts. The decrease in dollar volume also generated smaller investable balances that reduced investment income and more significantly lowered fees from carrier services. Expense management dollar volume declined as competitor consolidation in the market offset success in growing new accounts. Gains on sales of investment securities increased significantly as the Company took advantage of market gains.

Net Interest Income

Net interest income is the difference between interest earned on loans, investments, and other earning assets and interest expense on deposits and other interest-bearing liabilities. Net interest income is a significant source of the Company s revenues. The following table summarizes the changes in tax-equivalent net interest income and related factors:

	December 31,			% Change	
(In thousands)	**2016**	**2015**	**2014**	**2016 v. 2015**	**2015 v. 2014**
Average earning assets	$ 1,308,914	$ 1,244,797	$ 1,242,549	5.2%	0.2%
Net interest income*	$ 43,402	$ 42,025	$ 42,587	3.3%	(1.3)%
Net interest margin*	3.32%	3.38%	3.43%		
Yield on earning assets*	3.47%	3.55%	3.63%		
Rate on interest bearing liabilities	.48%	.51%	.58%		

* Presented on a tax-equivalent basis using a tax rate of 35% in all years.

Net interest income in 2016 compared to 2015:

The increase in net interest income was primarily due to an increase in average earning assets. This was partially offset by a decrease in the net interest margin due to the difficulty finding acceptable investment alternatives in the current low interest rate environment. More information is contained in the tables below and in Item 7A of this report.

Total average loans increased $7,042,000, or 1%, to $678,061,000. Loans have a positive effect on interest income and the net interest margin due to the fact that loans are one of the Company s highest yielding earning assets for any given maturity.

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Total average investment in securities and certificates of deposit increased $25,537,000, or 8%. The investment portfolio will expand and contract over time as the Company manages its liquidity and interest rate position. All purchases were made in accordance with the Company s investment policy. Total average federal funds sold and other short-term investments increased $34,621,000, or 31%. Interest bearing deposits in other financial institutions decreased $3,083,000, or 2%.

The Bank s total average interest-bearing deposits increased $7,255,000, or 2%, compared to the prior year. Average rates paid on interest-bearing liabilities decreased from .51% to ..48% as a result of the continued low interest rate environment.

Net interest income in 2015 compared to 2014:

The decrease in net interest income was caused by a decrease in net interest margin. The decrease in net interest margin was due to the lack of satisfactory investment alternatives in this historically low interest rate environment. More information is contained in the tables below and in Item 7A of this report.

Total average loans increased $7,195,000, or 1%, to $671,019,000. Loans have a positive effect on interest income and the net interest margin due to the fact that loans are one of the Company s highest yielding earning assets for any given maturity.

Total average investment in securities and certificates of deposit increased $12,557,000, or 4%. The investment portfolio will expand and contract over time as the Company manages its liquidity and interest rate position. All purchases were made in accordance with the Company s investment policy. Interest bearing deposits in other financial institutions decreased $7,189,000, or 5%. Total average federal funds sold and other short-term investments decreased $10,315,000, or 8%.

The Bank s total average interest-bearing deposits decreased $8,059,000, or 2%, compared to the prior year. Average rates paid on interest-bearing liabilities decreased from .58% to ..51% as a result of the continued low interest rate environment.

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Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rate and Interest Differential

The following table contains condensed average balance sheets for each of the periods reported, the tax-equivalent interest income and expense on each category of interest-earning assets and interest-bearing liabilities, and the average yield on such categories of interest-earning assets and the average rates paid on such categories of interest-bearing liabilities for each of the periods reported:

	2016			2015			2014		
(In thousands)	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Interest Income/ Expense**	**Yiel Rat**
Assets[1]									
Earning assets									
Loans[2, 3]:									
Taxable	$ 660,341	$ 28,506	4.32%	$ 649,472	$ 28,049	4.32%	$ 647,896	$ 29,316	4.52
Tax-exempt[4]	17,720	857	4.84	21,547	954	4.43	15,928	630	3.96
Securities[5]:									
Taxable	5,030	93	1.85	1,168	21	1.8	1,095	21	1.92
Tax-exempt[4]	347,099	14,858	4.28	328,927	14,553	4.42	316,991	14,480	4.57
Certificates of deposit	7,801	51	.65	4,298	17	0.4	3,750	8	0.21
Interest-bearing deposits in other financial institutions	124,991	638	.51	128,074	393	0.31	135,263	424	0.31
Federal funds sold and other short-term investments	145,932	428	.29	111,311	150	0.13	121,626	168	0.14
Total earning assets	1,308,914	45,431	3.47	1,244,797	44,137	3.55	1,242,549	45,047	3.63
Non-earning assets									
Cash and due from banks`	11,822			13,050			12,074		
Premise and equipment, net	20,503			18,544			14,793		
Bank owned life insurance	16,174			15,665			15,295		
Goodwill and other intangibles	13,799			14,187			14,593		
Other assets	144,165			145,178			137,503		
Allowance for loan losses	(10,903)			(11,910)			(11,840)		
Total assets	$ 1,504,474			$ 1,439,511			$ 1,424,967		
Liabilities and Shareholders Equity[1]									
Interest-bearing liabilities									
Interest-bearing demand deposits	$ 343,205	$ 1,388	.40%	$ 330,742	$ 1,392	.42%	$ 317,120	$ 1,564	0.49
Savings deposits	20,524	100	.49	14,656	65	.44	17,073	87	0.51
Time deposits >=$250	14,463	172	1.19	15,236	189	1.24	17,715	202	1.14
Other time deposits	44,468	369	.83	54,771	465	.85	71,556	607	0.85
Total interest-bearing deposits	422,660	2,029	.48	415,405	2,111	.51	423,464	2,460	0.58
Short-term borrowings				63	1	1.59	6		
Total interest-bearing liabilities	422,660	2,029	.48	415,468	2,112	.51	423,470	2,460	0.58
Non-interest bearing liabilities									
Demand deposits	192,315			164,347			147,575		
Accounts and drafts payable	654,845			632,604			643,077		
Other liabilities	27,594			29,239			10,696		
Total liabilities	1,297,414			1,241,658			1,224,818		
Shareholders equity	207,060			197,853			200,149		
Total liabilities and share-holders equity	$ 1,504,474			$ 1,439,511			$ 1,424,967		
Net interest income		$ 43,402			$ 42,025			$ 42,587	
Net interest margin			3.32%			3.38%			3.43
Interest spread			2.99%			3.04%			3.05

1 Balances shown are daily averages.

2 For purposes of these computations, nonaccrual loans are included in the average loan amounts outstanding. Interest on nonaccrual loans is recorded when received as discussed further in Item 8, Note 1 of this report.

3 Interest income on loans includes net loan fees of $586,000, $469,000, and $325,000 for 2016, 2015 and 2014, respectively.

4 Interest income is presented on a tax-equivalent basis assuming a tax rate 35% in all years. The tax-equivalent adjustment was approximately $5,500,000, $5,427,000 and $5,288,000 for 2016, 2015 and 2014, respectively.

5 For purposes of these computations, yields on investment securities are computed as interest income divided by the average amortized cost of the investments.

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Analysis of Net Interest Income Changes

The following table presents the changes in interest income and expense between years due to changes in volume and interest rates.

	2016 Over 2015			2015 Over 2014		
(In thousands)	**Volume[1]**	**Rate[1]**	**Total**	**Volume[1]**	**Rate[1]**	**Total**
Increase (decrease) in interest income:						
Loans[2,3]:						
Taxable	$ 469	$ (12)	$ 457	$ 71	$ (1,338)	$ (1,267)
Tax-exempt[4]	(180)	83	(97)	243	81	324
Securities:						
Taxable	71	1	72	1	(1)	
Tax-exempt[4]	789	(484)	305	536	(463)	73
Certificates of deposit	19	15	34	1	8	9
Interest-bearing deposits in other financial institutions	(10)	255	245	(22)	(9)	(31)
Federal funds sold and other short-term investments	58	220	278	(14)	(4)	(18)
Total interest income	$ 1,216	$ 78	$ 1,294	$ 816	$ (1,726)	$ (910)
Interest expense on:						
Interest-bearing demand deposits	$ 52	$ (56)	$ (4)	$ 65	$ (237)	$ (172)
Savings deposits	28	7	35	(11)	(11)	(22)
Time deposits >=$250	(9)	(8)	(17)	(30)	17	(13)
Other time deposits	(86)	(10)	(96)	(143)	1	(142)
Short-term borrowings	(1)		(1)	1		1
Total interest expense	(16)	(67)	(83)	(118)	(230)	(348)
Net interest income	$ 1,232	$ 145	$ 1,377	$ 934	$ (1,496)	$ (562)

1 The change in interest due to the combined rate/volume variance has been allocated in proportion to the absolute dollar amounts of the change in each.

2 Average balances include nonaccrual loans.

3 Interest income includes net loan fees.

4 Interest income is presented on a tax-equivalent basis assuming a tax rate of 35% in all years.

Loan Portfolio

Interest earned on the loan portfolio is a primary source of income for the Company. The loan portfolio was $664,866,000 and represented 44% of the Company's total assets as of December 31, 2016 and generated $29,063,000 in revenue during the year then ended. The Company had no sub-prime mortgage loans or residential development loans in its portfolio for any of the years presented. The following tables show the composition of the loan portfolio at the end of the periods indicated and remaining maturities for loans as of December 31, 2016.

Loans by Type			**December 31,**		
(In thousands)	**2016**	**2015**	**2014**	**2013**	**2012**
Commercial and industrial	$ 214,767	$ 193,430	$ 203,350	$ 171,304	$ 160,862
Real estate (commercial and church):					
Mortgage	425,947	415,564	423,641	455,190	502,961
Construction	17,477	30,139	18,612	16,449	23,475
Industrial Revenue Bond	6,639	19,831	23,348	9,167	
Other	36	91	395	67	435
Total loans	$ 664,866	$ 659,055	$ 669,346	$ 652,177	$ 687,733

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Loans by Maturity

(At December 31, 2016)	One Year Or Less		Over 1 Year Through 5 Years		Over 5 Years		
(In thousands)	Fixed Rate	Floating Rate[1]	Fixed Rate	Floating Rate[1]	Fixed Rate	Floating Rate[1]	Total
Commercial and industrial	$ 918	$ 91,414	$ 38,851	$ 38,009	$ 21,950	$ 23,625	$ 214,767
Real Estate:							
Mortgage	35,269	2,221	294,055	22,652	62,751	8,999	425,947
Construction	5,786	6,135	477		341	4,738	17,477
Industrial Revenue Bonds			6,639		__		6,639
Other		36					36
Total loans	$ 41,973	$ 99,806	$ 340,022	$ 60,661	$ 85,042	$ 37,362	$ 664,866

1 Loans have been classified as having "floating" interest rates if the rate specified in the loan varies with the prime commercial rate of interest. Note: Due to the historically low interest rates, the Company instituted a 4% floor for its prime lending rate.

The Company has no concentrations of loans exceeding 10% of total loans, which are not otherwise disclosed in the loan portfolio composition table and as are discussed in Item 8, Note 4, of this report. As can be seen in the loan composition table above and as discussed in Item 8, Note 4, the Company's primary market niche for banking services is privately held businesses and churches and church-related ministries.

Loans to commercial entities are generally secured by the business assets of the borrower, including accounts receivable, inventory, machinery and equipment, and the real estate from which the borrower operates. Operating lines of credit to these companies generally are secured by accounts receivable and inventory, with specific percentages of each determined on a customer-by-customer basis based on various factors including the type of business. Intermediate term credit for machinery and equipment is generally provided at some percentage of the value of the equipment purchased, depending on the type of machinery or equipment purchased by the entity. Loans secured exclusively by real estate to businesses and churches are generally made with a maximum 80% loan to value ratio, depending upon the Company's estimate of the resale value and ability of the property to generate cash. The Company's loan policy requires an independent appraisal for all loans over $250,000 secured by real estate. Company management monitors the local economy in an attempt to determine whether it has had a significant deteriorating effect on such real estate loans. When problems are identified, appraised values are updated on a continual basis, either internally or through an updated external appraisal.

Loan portfolio changes from December 31, 2015 to December 31, 2016:

Total loans increased $5,811,000, or 1%, to $664,866,000. Additional details regarding the types and maturities of loans in the loan portfolio are contained in the tables above and in Item 8, Note 4.

Loan portfolio changes from December 31, 2014 to December 31, 2015:

Total loans decreased $10,291,000, or 2%, to $659,055,000. Additional details regarding the types and maturities of loans in the loan portfolio are contained in the tables above and in Item 8, Note 4.

Provision and Allowance for Loan Losses (ALLL)

The Company recorded a ($1,500,000) provision for loan losses in 2016, ($850,000) in 2015 and $0 in 2014. The amount of the provisions for loan losses was derived from the Company s quarterly analysis of the ALLL. The amount of the provision will fluctuate as determined by these quarterly analyses. The Company had net loan recoveries of $40,000, $591,000, and $215,000 in 2016, 2015, and 2014, respectively. The ALLL was $10,175,000 at December 31, 2016 compared to $11,635,000 at December 31, 2015 and $11,894,000 at December 31, 2014. The year-end 2016 allowance represented 1.5% of outstanding loans, while the allowance represented 1.8% of outstanding loans at both year-end 2015 and 2014. From December 31, 2015 to December 31, 2016, the level of nonperforming loans decreased $2,890,000 from $3,135,000 to $245,000, which represents .04% of outstanding loans. Nonperforming loans are more fully explained in the section entitled Nonperforming Assets.

The ALLL has been established and is maintained to absorb reasonably estimated and probable losses in the loan portfolio. An ongoing assessment is performed to determine if the balance is adequate. Charges or credits are made to expense to cover any deficiency or reduce any excess, as required. The current methodology consists of two components: 1) estimated credit losses on individually evaluated loans that are determined to be impaired in accordance with FASB ASC 310 - *Allowance for Credit Losses* and 2) estimated credit losses inherent in the remainder of the loan portfolio in accordance with FASB ASC 450 - *Contingencies*. Estimated credit losses is an estimate of the current amount of loans that is probable the Company will be unable to collect according to the original terms.

For loans that are individually evaluated, the Company uses two impairment measurement methods: 1) the present value of expected future cash flows and 2) collateral value. For the remainder of the portfolio, the Company groups loans with similar risk characteristics into eight segments and applies historical loss rates to each segment based on a five fiscal-year look-back period. In addition, qualitative factors including credit concentration risk, national and local economic conditions, nature and volume of loan portfolio, legal and regulatory factors, downturns in specific industries including losses in collateral values, trends in credit quality at the Company and in the banking industry and trends in risk-rating agencies are are also considered.

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The Company also utilizes ratio analysis to evaluate the overall reasonableness of the ALLL compared to its peers and required levels of regulatory capital. Federal and state agencies review the Company s methodology for maintaining the ALLL. These agencies may require the Company to adjust the ALLL based on their judgments and interpretations about information available to them at the time of their examinations.

The following schedule summarizes activity in the ALLL and the allocation of the allowance to the Company s loan categories.

Summary of Loan Loss Experience

			December 31,		
(In thousands)	**2016**	**2015**	**2014**	**2013**	**2012**
Allowance at beginning of year	$ 11,635	$ 11,894	$ 11,679	$ 12,357	$ 12,954
Loans charged-off:					
Commercial and industrial		30		1,307	1,546
Real estate (commercial and church):					
Mortgage			76	233	1,562
Construction					
Other			3		
Total loans charged-off		30	79	1,540	3,108
Recoveries of loans previously charged-off:					
Commercial and industrial	39	610	41	47	111
Real estate (commercial and church):					
Mortgage	1	10	252	315	
Construction					
Other		1	1		
Total recoveries of loans previously charged-off	40	621	294	362	111
Net loans (recovered) charged-off	(40)	(591)	(215)	1,178	2,997
Provision (credited) charged to expense	(1,500)	(850)		500	2,400
Allowance at end of year	$ 10,175	$ 11,635	$ 11,894	$ 11,679	$ 12,357
Loans outstanding:					
Average	$ 678,061	$ 671,019	$ 663,824	$ 659,422	$ 684,597
December 31	664,866	659,055	669,346	652,177	687,733
Ratio of allowance for loan losses to loans outstanding:					
Average	1.50%	1.76%	1.79%	1.77%	1.81%
December 31	1.53%	1.77%	1.78%	1.79%	1.80%
Ratio of net (recoveries) charge-offs to average loans outstanding	(.01)%	(.09)%	(.03)%	.18%	.44%
Allocation of allowance for loan losses[1]:					
Commercial and industrial	$ 3,261	$ 3,083	$ 3,515	$ 3,139	$ 3,192
Real estate (commercial and church):					
Mortgage	5,689	6,885	7,076	7,439	8,687
Construction	132	226	140	124	470
Industrial Revenue Bond	101	320	394	155	
Other[2]	992	1,121	769	822	8
Total	$ 10,175	$ 11,635	$ 11,894	$ 11,679	$ 12,357
Percentage of categories to total loans:					
Commercial and industrial	32.3%	29.3%	30.4%	26.3%	23.4%
Real estate (commercial and church):					
Mortgage	64.1%	63.1%	63.3%	69.8%	73.1%
Construction	2.6%	4.6%	2.8%	2.5%	3.4%
Industrial Revenue Bond	1.0%	3.0%	3.5%	1.4%	%
Other	%	%	%	%	0.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

1 Although specific allocations exist, the entire allowance is available to absorb losses in any particular loan category.

2 Includes unallocated of $992,000 and $1,121,000 in 2016 and 2015, respectively.

Nonperforming Assets

Nonperforming loans are defined as loans on non-accrual status and loans 90 days or more past due but still accruing. Nonperforming assets include nonperforming loans plus foreclosed real estate. Troubled debt restructurings are not included in nonperforming loans unless they are on non-accrual status or past due 90 days or more.

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It is the policy of the Company to continually monitor its loan portfolio and to discontinue the accrual of interest on any loan for which collection is not probable. Subsequent payments received on such loans are applied to principal if collection of principal is not probable; otherwise, these receipts are recorded as interest income. Interest on nonaccrual loans, which would have been recorded under the original terms of the loans, was approximately $66,000 and $390,000 for the years ended December 31, 2016 and 2015, respectively. Of this amount, approximately $47,000 and $34,000 was actually recorded as interest income on such loans during the years ended December 31, 2016 and 2015, respectively.

Total nonaccrual loans at December 31, 2016 consists of one loan totaling $245,000 that relates to a business that has a weak financial position. No allocation of the allowance for loan losses has been established as no loss on this credit is anticipated.

There were no foreclosed assets at December 31, 2016 and December 31, 2015.

The Company does not have any foreign loans. The Company's loan portfolio does not include a significant amount of single family real estate mortgages, as the Company does not market its services to retail customers. Also, the Company had no sub-prime mortgage loans or residential development loans in its portfolio in any of the years presented.

The Company does not have any other interest-earning assets which would have been included in nonaccrual, past due or restructured loans if such assets were loans.

Summary of Nonperforming Assets

	December 31,				
(In thousands)	**2016**	**2015**	**2014**	**2013**	**2012**
Commercial and industrial:					
Nonaccrual	$	$	$	$ 11	$ 1,439
Contractually past due 90 days or more and still accruing					
Real estate mortgage:					
Nonaccrual	245	3,135*	488	1,786	5,133*
Contractually past due 90 days or more and still accruing					
Total nonperforming loans	$ 245	$ 3,135	$ 488	$ 1,797	$ 6,572
Total foreclosed assets					1,322
Total nonperforming assets	$ 245	$ 3,135	$ 488	$ 1,797	$ 7,894

* In February 2016, one nonaccrual loan with a balance of $2,727,000 was paid in full. In February 2013, a payment of $4,115,000 was received for one nonaccrual loan with a balance of $4,198,000. $83,000 was charged off.

Operating Expenses

Operating expenses in 2016 compared to 2015 include the following significant pre-tax components:

Salaries and employee benefits expense increased $2,267,000, or 3%, to $72,581,000 as the Company invested in staff and technology to win and support new business. Equipment expense increased $160,000 to $4,451,000 primarily due to depreciation of internally developed software. Other operating expense increased $1,273,000, or 11%, to $12,643,000 primarily due to a one-time litigation settlement that occurred in 2015 ($800,000 reduction in other operating expenses).

Operating expenses in 2015 compared to 2014 include the following significant pre-tax components:

Salaries and employee benefits expense increased $4,214,000, or 6%, to $70,314,000 as the Company invested in staff and technology to win and support new business. Occupancy expense increased $228,000, or 7%, due to the expansion of the Company s operating facilities for its transportation and waste management operations. Equipment expense increased $161,000 to $4,291,000 primarily due to depreciation on new furniture and additional systems hardware and software. Amortization of intangibles decreased $75,000 to $408,000. Other operating expense decreased $159,000, or 1%, to $11,370,000 primarily due to a one-time litigation settlement that occurred in 2015($800,000 reduction in other operating expenses).

Income Tax Expense

Income tax expense in 2016 totaled $7,716,000 compared to $7,978,000 and $7,759,000 in 2015 and 2014, respectively. When measured as a percent of income, the Company s effective tax rate was 24% in 2016, 26% in 2015, and 24% in 2014. The Company was able to take advantage of tax benefits related to the continued investment in technology and a result of the Bank s REIT holding a portion of the loan portfolio. Additionally, the effective tax rate varies from year-to-year primarily due to changes in the Company s pre-tax income and the amount of investment in tax-exempt municipal bonds.

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Investment Portfolio

Investment portfolio changes from December 31, 2015 to December 31, 2016:

State and political subdivision securities increased modestly to $370,134,000. U.S. government agency securities increased to $12,672,000. The investment portfolio provides the Company with a significant source of earnings, secondary source of liquidity, and mechanisms to manage the effects of changes in loan demand and interest rates. Therefore, the size, asset allocation and maturity distribution of the investment portfolio will vary over time depending on management s assessment of current and future interest rates, changes in loan demand, changes in the Company s sources of funds and the economic outlook. During this period, the Company purchased state and political subdivision along with U.S. government agency securities. These securities all had A or better credit ratings and maturities approaching 15 years. With the additional liquidity provided by the increase in deposits and accounts and drafts payable, the Company made these purchases to continue to reduce the level of short-term rate sensitive assets. All purchases were made in accordance with the Company s investment policy.

There was no single issuer of securities in the investment portfolio at December 31, 2016 for which the aggregate amortized cost exceeded 10% of total shareholders' equity.

Investments by Type

(In thousands)	December 31, 2016	2015	2014
State and political subdivisions	$ 370,134	$ 369,070	$ 352,391
U.S. government agencies	12,672		
Certificates of deposit	7,746	6,626	3,750
Total investments	$ 390,552	$ 375,696	$ 356,141

Investment Securities by Maturity
(At December 31, 2016)

(In thousands)	Within 1 Year	Over 1 to 5 Years	Over 5 to 10 Years	Over 10 Years	Yield
State and political subdivisions	$ 27,875	$ 56,918	$ 159,366	$ 125,975	3.89%
U.S. government agencies				12,672	1.99%
Certificates of deposit	6,250	1,496			.68%
Total investments	$ 34,125	$ 58,414	$ 159,366	$ 138,647	3.82%
Weighted average yield[1]	4.59%	3.98%	3.91%	3.32%	3.76%

1 Weighted average yield is presented on a tax-equivalent basis assuming a tax rate of 35%.

Deposits and Accounts and Drafts Payable

Noninterest-bearing demand deposits increased 18% from December 31, 2015 to $214,656,000 at December 31, 2016. The average balances of these deposits increased 17% in 2016 to $192,315,000. These balances are primarily maintained by commercial customers and churches and can fluctuate on a daily basis.

Interest-bearing deposits decreased $57,356,000, or 12%, to $407,305,000 at December 31, 2016. The average balances of these deposits increased to $422,660,000 in 2016 from $415,405,000 in 2015.

Accounts and drafts payable generated by the Company in its payment processing operations increased $65,028,000, or 11%, to $642,287,000 at December 31, 2016. The average balance of these funds increased $22,241,000, or 4%, to $654,845,000 in 2016. This increase was the result of supplier payment optimization that more than offset the drop in energy prices which reduced the average transportation and expense management invoice amounts. Due to the Company s payment processing cycle, average balances are much more indicative of the underlying activity than period-end balances since point-in-time comparisons can be misleading if the comparison dates fall on different days of the week.

The composition of average deposits and the average rates paid on those deposits is represented in the table entitled Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rate and Interest Differential which is included earlier in this discussion. The Company does not have any significant deposits from foreign depositors.

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Maturities of Certificates of Deposit as of December 31, 2016

(In thousands)	$100 or Less	$100 to Less Than $250	$250 or More	Total
Three months or less	$ 1,399	$ 29,215	$ 1,995	$ 32,609
Three to six months	673	6,043	3,826	10,542
Six to twelve months	602	434	4,553	5,589
Over twelve months	849	1,487	4,708	7,044
Total	$ 3,523	$ 37,179	$ 15,082	$ 55,784

Liquidity

The discipline of liquidity management as practiced by the Company seeks to ensure that funds are available to fulfill all payment obligations relating to invoices processed as they become due and meet depositor withdrawal requests and borrower credit demands while at the same time maximizing profitability. This is accomplished by balancing changes in demand for funds with changes in supply of funds. Primary liquidity to meet demand is provided by short-term liquid assets that can be converted to cash, maturing securities and the ability to obtain funds from external sources. The Company's Asset/Liability Committee (ALCO) has direct oversight responsibility for the Company's liquidity position and profile. Management considers both on-balance sheet and off-balance sheet items in its evaluation of liquidity.

The balances of liquid assets consist of cash and cash equivalents, which include cash and due from banks, interest-bearing deposits in other financial institutions, federal funds sold, and money market funds, totaled $266,714,000 at December 31, 2016, an increase of $13,571,000, or 5%, from December 31, 2015. At December 31, 2016, these assets represented 18% of total assets. Cash and cash equivalents are the Company s and its subsidiaries primary source of liquidity to meet future expected and unexpected loan demand, depositor withdrawals or reductions in accounts and drafts payable.

Secondary sources of liquidity include the investment portfolio and borrowing lines. Total investment in debt securities available-for-sale at fair value was $390,552,000 at December 31, 2016, an increase of $14,856,000, or 4%, from December 31, 2015. These assets represented 26% of total assets at December 31, 2016 and were primarily state and political subdivision securities. Of the total portfolio, 9% mature in one year or less, 15% mature after one year through five years and 76% mature after five years. The Company sold $21,491,000 in securities available-for-sale during 2016.

As of December 31, 2016, the Bank had unsecured lines of credit at correspondent banks to purchase federal funds up to a maximum of $78,000,000 at the following banks: Bank of America, $10,000,000; US Bank, $20,000,000; Wells Fargo Bank, $15,000,000; PNC Bank, $12,000,000; Frost National Bank, $10,000,000; JPM Chase Bank, $6,000,000; and UMB Bank $5,000,000. As of December 31, 2016, the Bank had secured lines of credit with the Federal Home Loan Bank (FHLB) of $205,768,000 collateralized by commercial mortgage loans. At December 31, 2016, the Company had a line of credit from UMB Bank of $50,000,000 and First Tennessee Bank of $50,000,000 collateralized by state and political subdivision securities. There were no amounts outstanding under any of the lines of credit discussed above at December 31, 2016 or 2015.

The deposits of the Company's banking subsidiary have historically been stable, consisting of a sizable volume of core deposits related to customers that utilize many other commercial products of the Bank. The accounts and drafts payable generated by the Company have also historically been a stable source of funds.

Net cash flows provided by operating activities for the years 2016, 2015 and 2014 were $35,189,000, $33,493,000 and $34,843,000, respectively. Net income plus depreciation and amortization accounts for most of the operating cash provided. Net cash flows from investing and financing activities fluctuate greatly as the Company actively manages its investment and loan portfolios and customer activity influences changes in deposit and accounts and drafts payable balances. Further analysis of the changes in these account balances is discussed earlier in this report. Due to the daily fluctuations in these account balances, management believes that the analysis of changes in average balances, also discussed earlier in this report, can be more indicative of underlying activity than the period-end balances used in the statements of cash flows. Management anticipates that cash and cash equivalents, maturing investments, cash from operations, and borrowing lines will continue to be sufficient to fund the Company s operations and capital expenditures in 2017. The Company anticipates the annual capital expenditures for 2017 should range from $3 million to $5 million. Capital expenditures in 2017 are expected to consist of equipment and software related to the payment and information processing services business.

There are several trends and uncertainties that may impact the Company s ability to generate revenues and income at the levels that it has in the past. In addition, these trends and uncertainties may impact available liquidity. Those that could significantly impact the Company include the general levels of interest rates, business activity, and energy costs as well as new business opportunities available to the Company.

As a financial institution, a significant source of the Company s earnings is generated from net interest income. Therefore, the prevailing interest rate environment is important to the Company s performance. A major portion of the Company s funding sources are the non-interest bearing accounts and drafts payable generated from its payment and information processing services. Accordingly, higher levels of interest rates will generally allow the Company to earn more net interest income. Conversely, a lower interest rate environment will generally tend to depress net interest income. The Company actively manages its balance sheet in an effort to maximize net interest income as the interest rate environment changes. This balance sheet management impacts the mix of earning assets maintained by the Company at any point in time. For example, in a low interest rate environment, short-term relatively lower rate liquid investments may be reduced in favor of longer term relatively higher yielding investments and loans. If the primary source of liquidity is reduced in a low interest rate environment, a greater reliance would be placed on secondary sources of liquidity including borrowing lines, the ability of the Bank to generate deposits, and the investment portfolio to ensure overall liquidity remains at acceptable levels.

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The overall level of economic activity can have a significant impact on the Company s ability to generate revenues and income, as the volume and size of customer invoices processed may increase or decrease. Lower levels of economic activity decrease both fee income (as fewer invoices are processed) and balances of accounts and drafts payable generated (as fewer invoices are processed) from the Company s transportation customers.

The relative level of energy costs can impact the Company s earnings and available liquidity. Lower levels of energy costs will tend to decrease transportation and energy invoice amounts resulting in a corresponding decrease in accounts and drafts payable. Decreases in accounts and drafts payable generate lower interest income and reduce liquidity.

New business opportunities are an important component of the Company s strategy to grow earnings and improve performance. Generating new customers allows the Company to leverage existing systems and facilities and grow revenues faster than expenses. During 2016, new business was added in both the transportation and facility expense management operations, driven by both successful marketing efforts and the solid market leadership position held by Cass.

Capital Resources

One of management s primary objectives is to maintain a strong capital base to warrant the confidence of customers, shareholders, and bank regulatory agencies. A strong capital base is needed to take advantage of profitable growth opportunities that arise and to provide assurance to depositors and creditors. The Company and its banking subsidiary continue to exceed all regulatory capital requirements, as evidenced by the capital ratios at December 31, 2016 as shown in Item 8, Note 2 of this report.

In 2016, cash dividends paid were $.89 per share for a total of $9,979,000, an increase of $282,000, or 3%, compared to $.85 per share for a total of $9,697,000 in 2015. The increase is attributable to the per-share amount paid.

Shareholders equity was $208,035,000, or 14% of total assets, at December 31, 2016, an increase of $657,000 over the balance at December 31, 2015. This increase resulted primarily from net income of $24,348,000 and an increase in additional paid in capital related to equity compensation of $4,760,000. These increases were partially offset by the repurchase of treasury shares of $9,215,000, cash dividends of $9,979,000, and a decrease in other comprehensive income of $7,879,000.

Dividends from the Bank are a source of funds for payment of dividends by the Company to its shareholders. The only restrictions on dividends are those dictated by regulatory capital requirements, state corporate laws and prudent and sound banking principles. As of December 31, 2016, unappropriated retained earnings of $26,374,000 were available at the Bank for the declaration of dividends to the Company without prior approval from regulatory authorities.

The Company maintains a treasury stock buyback program pursuant to which the Board of Directors has authorized the repurchase of up to 500,000 shares of the Company s common stock. The Company repurchased 187,123 shares at an aggregate cost of $9,215,000 during the year ended December 31, 2016 and 216,412 shares at an aggregate cost of $10,591,000 during the year ended December 31, 2015. As of December 31, 2016, 500,000 shares remained available for repurchase under the program. A portion of the repurchased shares may be used for the Company's employee benefit plans, and the balance will be available for other general corporate purposes. The stock repurchase authorization does not have an expiration date and the pace of repurchase activity will depend on factors such as levels of cash generation from operations, cash requirements for investments, repayment of debt, current stock price, and other factors. The Company may repurchase shares from time to time on the open market or in private transactions, including structured transactions. The stock repurchase program may be modified or discontinued at any time.

Commitments, Contractual Obligations and Off-Balance Sheet Arrangements

In the normal course of business, the Company is party to activities that involve credit, market and operational risk that are not reflected in whole or in part in the Company s consolidated financial statements. Such activities include traditional off-balance sheet credit-related financial instruments and commitments under operating and capital leases. These financial instruments include commitments to extend credit, commercial letters of credit and standby letters of credit. The Company s maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, commercial letters of credit and standby letters of credit is represented by the contractual amounts of those instruments. At December 31, 2016, no amounts have been accrued for any estimated losses for these instruments.

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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. Commercial and standby letters of credit are conditional commitments issued by the Company or its subsidiaries to guarantee the performance of a customer to a third party. These off-balance sheet financial instruments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2016, the balance of loan commitments, standby and commercial letters of credit were $45,497,000, $14,381,000 and $1,962,000, respectively. Since some of the financial instruments may expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. Commitments to extend credit and letters of credit are subject to the same underwriting standards as those financial instruments included on the consolidated balance sheets. The Company evaluates each customer s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of the credit, is based on management s credit evaluation of the borrower. Collateral held varies, but is generally accounts receivable, inventory, residential or income-producing commercial property or equipment. In the event of nonperformance, the Company or its subsidiaries may obtain and liquidate the collateral to recover amounts paid under its guarantees on these financial instruments.

The following table summarizes contractual cash obligations of the Company related to operating lease commitments and time deposits at December 31, 2016:

		Amount of Commitment Expiration per Period			
(In thousands)	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**Over 5 Years**
Operating lease commitments	$ 6,285	$ 1,490	$ 2,211	$ 1,751	$ 833
Time deposits	55,784	48,740	4,907	2,137	
Total	$ 62,069	$ 50,230	$ 7,118	$ 3,888	$ 833

During 2016, the Company made no contribution to its noncontributory defined benefit pension plan. In determining pension expense, the Company makes several assumptions, including the discount rate and long-term rate of return on assets. These assumptions are determined at the beginning of the plan year based on interest rate levels and financial market performance. For 2016, these assumptions were as follows:

Assumption	**Rate**
Weighted average discount rate	4.50%
Rate of increase in compensation levels	(a)
Expected long-term rate of return on assets	6.75%

(a) 6.00% graded down to 3.25% over the first seven years of service.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity

The Company faces market risk to the extent that its net interest income and its fair market value of equity are affected by changes in market interest rates. The asset/liability management discipline as applied by the Company seeks to limit the volatility, to the extent possible, of both net interest income and the fair market value of equity that can result from changes in market interest rates. This is accomplished by limiting the maturities of fixed rate investments, loans, and deposits; matching fixed rate assets and liabilities to the extent possible; and optimizing the mix of fees and net interest income. However, as discussed below, the Company's asset/liability position often differs significantly from most other financial holding companies with significant positive cumulative "gaps" shown for each time horizon presented. This asset sensitive position is caused primarily by the operations of the Company, which generate large balances of accounts and drafts payable. These balances, which are noninterest bearing, contribute to the Company s historical high net interest margin but cause the Company to become susceptible to changes in interest rates, with a decreasing net interest margin and fair market value of equity in periods of declining interest rates and an increasing net interest margin and fair market value of equity in periods of rising interest rates.

The Company s ALCO measures the Company's interest rate risk sensitivity on a quarterly basis to monitor and manage the variability of earnings and fair market value of equity in various interest rate environments. The ALCO evaluates the Company's risk position to determine whether the level of exposure is significant enough to hedge a potential decline in earnings and value or whether the Company can safely increase risk to enhance returns. The ALCO uses gap reports, 12-month net interest income simulations, and fair market value of equity analyses as its main analytical tools to provide management with insight into the Company's exposure to changing interest rates.

Management uses a gap report to review any significant mismatch between the re-pricing points of the Company s rate sensitive assets and liabilities in certain time horizons. A negative gap indicates that more liabilities re-price in that particular time frame and, if rates rise, these liabilities will re-price faster than the assets. A positive gap would indicate the opposite. Gap reports can be misleading in that they capture only the re-pricing timing within the balance sheet, and fail to capture other significant risks such as basis risk and embedded options risk. Basis risk involves the potential for the spread relationship between rates to change under different rate environments and embedded options risk relates to the potential for the alteration of the level and/or timing of cash flows given changes in rates.

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Another measurement tool used by management is net interest income simulation, which forecasts net interest income during the coming 12 months under different interest rate scenarios in order to quantify potential changes in short-term accounting income. Management has set policy limits specifying acceptable levels of interest rate risk given multiple simulated rate movements. These simulations are more informative than gap reports because they are able to capture more of the dynamics within the balance sheet, such as basis risk and embedded options risk. A table containing simulation results as of December 31, 2016, from an immediate and sustained parallel change in interest rates is shown below.

While net interest income simulations do an adequate job of capturing interest rate risk to short term earnings, they do not capture risk within the current balance sheet beyond 12 months. The Company uses fair market value of equity analyses to help identify longer-term risk that may reside on the current balance sheet. The fair market value of equity is represented by the present value of all future income streams generated by the current balance sheet. The Company measures the fair market value of equity as the net present value of all asset and liability cash flows discounted at forward rates suggested by the current U.S. Treasury curve plus appropriate credit spreads. This representation of the change in the fair market value of equity under different rate scenarios gives insight into the magnitude of risk to future earnings due to rate changes. Management has set policy limits relating to declines in the market value of equity. The table below contains the analysis, which illustrates the effects of an immediate and sustained parallel change in interest rates as of December 31, 2016:

Change in Interest Rates	% Change in Net Interest Income	% Change in Fair Market Value of Equity
+200 basis points	6%	7%
+100 basis points	3%	4%
Stable rates		
-100 basis points	(4%)	(3%)
-200 basis points	(6%)	(5%)

Interest Rate Sensitivity Position

The following table presents the Company s interest rate risk position at December 31, 2016 for the various time periods indicated:

(In thousands)	Variable Rate	0-90 Days	91-180 Days	181-364 Days	1-5 Years	Over 5 Years	Total
Earning assets:							
Loans:							
Taxable	$ 202,281	$ 13,826	$ 12,365	$ 15,651	$ 329,062	$ 85,042	$ 658,227
Tax-exempt					6,336	303	6,639
Securities[1]:							
Tax-exempt		13,510	5,683	7,681	78,789	264,471	370,134
U.S. government agencies						12,672	12,672
Certificates of deposit		1,250	750	4,250	1,496		7,746
Investments in the FHLB and FRB	1,196						1,196
Federal funds sold and other short-term investments	254,929						254,929
Total earning assets	$ 458,406	$ 28,586	$ 18,798	$ 27,582	$ 415,683	$ 362,488	$ 1,311,543
Interest-sensitive liabilities:							
Money market accounts	$ 235,701	$	$	$	$	$	$ 235,701
Now accounts	86,390						86,390
Savings deposits	29,430						29,430
Time deposits:							
$250K and more		1,995	3,826	4,553	4,707		15,082
Less than $250K		30,614	6,717	1,037	2,335		40,702
Federal funds purchased and other short-term borrowing							
Total interest-bearing liabilities	$ 351,521	$ 32,609	$ 10,543	$ 5,590	$ 7,042	$	$ 407,305
Interest sensitivity gap:							
Periodic	$ 106,885	$ (4,023)	$ 8,255	$ 21,992	$ 408,640	$ 362,488	$ 904,237
Cumulative	106,885	102,862	111,117	133,109	541,749	904,237	904,237

Ratio of interest-bearing assets to interest-bearing liabilities:							
Periodic	1.30	0.88	1.78	4.93	59.03		3.22
Cumulative	1.30	1.27	1.28	1.33	2.33	3.22	3.22

[1] Balances shown reflect earliest re-pricing date.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands except share and per share data)	December 31, 2016	2015
Assets		
Cash and due from banks	$ 11,814	$ 9,015
Interest-bearing deposits in other financial institutions	136,852	176,405
Federal funds sold and other short-term investments	118,077	67,752
Cash and cash equivalents	266,743	253,172
Securities available-for-sale, at fair value	390,552	375,696
Loans	664,866	659,055
Less allowance for loan losses	10,175	11,635
Loans, net	654,691	647,420
Premises and equipment, net	21,086	19,648
Investments in bank-owned life insurance	16,445	15,933
Payments in excess of funding	105,347	105,526
Goodwill	11,590	11,590
Other intangible assets, net	1,997	2,405
Other assets	36,388	24,116
Total assets	$ 1,504,839	$ 1,455,506
Liabilities and Shareholders Equity		
Liabilities:		
Deposits		
Noninterest-bearing	$ 214,656	$ 181,823
Interest-bearing	407,305	464,661
Total deposits	621,961	646,484
Accounts and drafts payable	642,287	577,259
Other liabilities	32,556	24,385
Total liabilities	1,296,804	1,248,128
Shareholders Equity:		
Preferred stock, par value $.50 per share; 2,000,000 shares authorized and no shares issued		
Common stock, par value $.50 per share; 40,000,000 shares authorized, 11,931,147 shares issued at December 31, 2016 and 2015	5,966	5,966
Additional paid-in capital	128,455	126,290
Retained earnings	118,363	103,994
Common shares in treasury, at cost (742,681 and 598,875 shares at December 31, 2016 and 2015, respectively)	(30,206)	(22,208)
Accumulated other comprehensive loss	(14,543)	(6,664)
Total shareholders equity	208,035	207,378
Total liabilities and shareholders equity	$ 1,504,839	$ 1,455,506

See accompanying notes to consolidated financial statements.

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CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(In thousands except per share data)	For the Years Ended December 31, 2016	2015	2014
Fee Revenue and Other Income:			
Information services payment and processing revenue	$ 83,713	$ 78,622	$ 77,427
Bank service fees	1,276	1,223	1,132
Gains on sales of securities	387	2,910	23
Other	760	613	1,325
Total fee revenue and other income	86,136	83,368	79,907
Interest Income:			
Interest and fees on loans	29,063	28,669	29,726
Interest and dividends on securities:			
Taxable	143	38	29
Exempt from federal income taxes	9,658	9,460	9,412
Interest on federal funds sold and other short-term investments	1,066	543	592
Total interest income	39,930	38,710	39,759
Interest Expense:			
Interest on deposits	2,029	2,111	2,460
Total interest expense	2,029	2,111	2,460
Net interest income	37,901	36,599	37,299
Provision for loan losses	(1,500)	(850)	
Net interest income after provision for loan losses	39,401	37,449	37,299
Total net revenue	125,537	120,817	117,206
Operating Expense:			
Personnel	72,581	70,314	66,100
Occupancy	3,390	3,400	3,172
Equipment	4,451	4,291	4,130
Amortization of intangible assets	408	408	483
Other operating	12,643	11,370	11,529
Total operating expense	93,473	89,783	85,414
Income before income tax expense	32,064	31,034	31,792
Income tax expense	7,716	7,978	7,759
Net income	$ 24,348	$ 23,056	$ 24,033
Basic Earnings Per Share	$ 2.18	$ 2.03	$ 2.09
Diluted Earnings Per Share	2.15	2.00	2.06

See accompanying notes to consolidated financial statements.

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CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
(In thousands)	**2016**	**2015**	**2014**
Comprehensive income:			
Net income	$ 24,348	$ 23,056	$ 24,033
Other comprehensive income:			
Net unrealized (loss) gain on securities available-for-sale	(10,644)	1,527	8,333
Tax effect	3,954	(567)	(3,096)
Reclassification adjustments for gains included in net income	(387)	(2,910)	(23)
Tax effect	144	1,081	8
FASB ASC 715 adjustment	(1,435)	6,256	(14,621)
Tax effect	531	(2,324)	5,432
Foreign currency translation adjustments	(42)	(96)	(104)
Total comprehensive income	$ 16,469	$ 26,023	$ 19,962

See accompanying notes to consolidated financial statements.

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CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
(In thousands)	**2016**	**2015**	**2014**
Cash Flows From Operating Activities:			
Net income	$24,348	$23,056	$24,033
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,429	8,859	8,181
Net gains on sales of securities	(387)	(2,910)	(23)
Stock-based compensation expense	1,959	2,059	2,041
Provisions for loan losses	(1,500)	(850)	
Deferred income tax expense (benefit)	319	(137)	(621)
Increase (decrease) in income tax liability	357	47	(24)
Increase in pension liability	4,137	4,550	2,282
Other operating activities, net	(3,473)	(1,181)	(1,026)
Net cash provided by operating activities	35,189	33,493	34,843
Cash Flows From Investing Activities:			
Proceeds from sales of securities available-for-sale	21,491	99,347	587
Proceeds from maturities of securities available-for-sale	43,524	38,460	18,340
Purchase of securities available-for-sale	(96,290)	(161,279)	(54,054)
Net (increase) decrease in loans	(5,771)	10,882	(16,954)
Decrease (increase) in payments in excess of funding	179	14,701	(42,577)
Purchases of premises and equipment, net	(4,684)	(5,747)	(6,291)
Net cash used in investing activities	(41,551)	(3,636)	(100,949)
Cash Flows From Financing Activities:			
Net increase in noninterest-bearing demand deposits	32,833	22,824	15,158
Net (decrease) increase in interest-bearing demand and savings deposits	(51,440)	23,536	39,766
Net decrease in time deposits	(5,916)	(18,075)	(19,221)
Net increase (decrease) in accounts and drafts payable	65,028	(78,169)	111,475
Cash dividends paid	(9,979)	(9,697)	(9,337)
Purchase of common shares for treasury	(9,215)	(10,951)	(1,848)
Other financing activities, net	(1,378)	(488)	(814)
Net cash provided by (used in) financing activities	19,933	(71,020)	135,179
Net increase (decrease) in cash and cash equivalents	13,571	(41,163)	69,073
Cash and cash equivalents at beginning of year	253,172	294,335	225,262
Cash and cash equivalents at end of year	$ 266,743	$ 253,172	$ 294,335
Supplemental information:			
Cash paid for interest	$2,017	$2,133	$2,491
Cash paid for income taxes	7,061	8,190	8,476

See accompanying notes to consolidated financial statements.

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CASS INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(In thousands except per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2013	$ 5,966	$ 125,062	$ 75,939	$ (10,980)	$ (5,560)	$ 190,427
Net income			24,033			24,033
Cash dividends ($.81 per share)			(9,337)			(9,337)
Issuance of 22,629 common shares pursuant to stock-based compensation plan, net		(594)		(38)		(632)
Exercise of SARs		(340)		159		(181)
Stock-based compensation expense		2,041				2,041
Purchase of 39,502 common shares				(1,848)		(1,848)
Other comprehensive loss					(4,071)	(4,071)
Balance, December 31, 2014	$ 5,966	$ 126,169	$ 90,635	$ (12,707)	$ (9,631)	$ 200,432
Net income			23,056			23,056
Cash dividends ($.85 per share)			(9,697)			(9,697)
Issuance of 42,786 common shares pursuant to stock-based compensation plan, net		(1,250)		797		(453)
Exercise of SARs		(687)		293		(394)
Stock-based compensation expense		2,058				2,058
Purchase of 216,412 common shares				(10,591)		(10,591)
Other comprehensive income					2,967	2,967
Balance, December 31, 2015	$ 5,966	$ 126,290	$ 103,994	$ (22,208)	$ (6,664)	$ 207,378
Net income			24,348			24,348
Cash dividends ($.89 per share)			(9,979)			(9,979)
Issuance of 36,196 common shares pursuant to stock-based compensation plan, net		(1,231)		566		(665)
Exercise of SARs		(1,364)		651		(713)
Stock-based compensation expense		1,959				1,959
Purchase of 187,123 common shares				(9,215)		(9,215)
Excess tax benefits associated with stock based compensation		2,801				2,801
Other comprehensive loss					(7,879)	(7,879)
Balance, December 31, 2016	$ 5,966	$ 128,455	$ 118,363	$ (30,206)	$ (14,543)	$ 208,035

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1
Summary of Significant Accounting Policies

Summary of Operations Cass Information Systems, Inc. (the Company) provides payment and information services, which include processing and payment of transportation, energy, telecommunications and environmental invoices. These services include the acquisition and management of data, information delivery and financial exchange. The consolidated balance sheet captions, Accounts and drafts payable and Payments in excess of funding, represent the Company s resulting financial position related to the payment services that are performed for customers. The Company also provides a full range of banking services to individual, corporate and institutional customers through Cass Commercial Bank (the Bank), its wholly owned bank subsidiary.

Basis of Presentation The accounting and reporting policies of the Company and its subsidiaries conform to U.S. generally accepted accounting principles (GAAP). The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries after elimination of intercompany transactions. Certain amounts in the 2015 and 2014 consolidated financial statements have been reclassified to conform to the 2016 presentation. Such reclassifications have no effect on previously reported net income or shareholders equity.

Use of Estimates In preparing the consolidated financial statements, Company management is required to make estimates and assumptions which significantly affect the reported amounts in the consolidated financial statements.

Cash and Cash Equivalents For purposes of the consolidated statements of cash flows, the Company considers cash and due from banks, interest-bearing deposits in other financial institutions, federal funds sold and other short-term investments as segregated in the accompanying consolidated balance sheets to be cash equivalents.

Investment in Debt Securities The Company classifies its debt marketable securities as available-for-sale. Securities classified as available-for-sale are carried at fair value. Unrealized gains and losses, net of the related tax effect, are excluded from earnings and reported in accumulated other comprehensive income, a component of shareholders equity. A decline in the fair value of any available-for-sale security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. To determine whether impairment is other than temporary, the Company considers guidance provided in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 320 - *Investments Debt and Equity Securities*. When determining whether a debt security is other-than-temporarily impaired, the Company assesses whether it has the intent to sell the security and whether it is more likely than not that the Company will be required to sell prior to recovery of the amortized cost basis. Evidence considered in this assessment includes the reasons for impairment, the severity and duration of the impairment, changes in value subsequent to year-end and forecasted performance of the investee. Premiums and discounts are amortized or accreted to interest income over the estimated lives of the securities using the level-yield method. Interest income is recognized when earned. Gains and losses are calculated using the specific identification method.

Allowance for Loan Losses (ALLL) The ALLL is increased by provisions charged to expense and is available to absorb charge-offs, net of recoveries. Management utilizes a systematic, documented approach in determining the appropriate level of the ALLL. Management s approach provides for estimated credit losses on individually evaluated loans in accordance with FASB ASC 310 - *Allowance for Credit Losses* (ASC 310). These estimates are based upon a number of factors, such as payment history, financial condition of the borrower, expected future cash flows and discounted collateral exposure.

Estimated credit losses inherent in the remainder of the portfolio are estimated in accordance with FASB ASC 450 - *Contingencies*. These loans are segmented into groups based on similar risk characteristics. Historical loss rates for each risk group, which are updated quarterly, are generally quantified using all recorded loan charge-offs and recoveries over a prescribed look-back period. These historical loss rates for each risk group are used as the starting point to determine the level of the allowance. The Company s methodology incorporates an estimated loss emergence period for each risk group. The loss emergence period is the period of time from when a borrower experiences a loss event and when the actual loss is recognized in the financial statements, generally at the time of initial charge-off of the loan balance. The Company s methodology also includes qualitative risk factors that allow management to adjust its estimates of losses based on the most recent information available and to address other limitations in the quantitative component that is based on historical loss rates. Such risk factors are generally reviewed and updated quarterly, as appropriate, and are adjusted to reflect changes in national and local economic conditions and developments, the volume and severity of delinquent and internally classified loans, loan concentrations, assessment of trends in collateral values, assessment of changes in borrowers financial stability, and changes in lending policies and procedures, including underwriting standards and collections, charge-off and recovery practices.

Management believes the ALLL is adequate to absorb probable losses in the loan portfolio. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review the Company s ALLL. Such agencies may require the Company to increase the ALLL based on their judgments and interpretations about information available to them at the time of their examinations.

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Premises and Equipment Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed over the estimated useful lives of the assets, or the respective lease terms for leasehold improvements, using straight-line and accelerated methods. Estimated useful lives do not exceed 40 years for buildings, the lesser of 10 years or the life of the lease for leasehold improvements and range from 3 to 7 years for software, equipment, furniture and fixtures. Maintenance and repairs are charged to expense as incurred.

Intangible Assets Cost in excess of fair value of net assets acquired has resulted from business acquisitions. Goodwill and intangible assets with indefinite useful lives are not amortized, but instead are tested for impairment at least annually. Intangible assets with definite useful lives are amortized on a straight-line basis over their respective estimated useful lives.

Periodically, the Company reviews intangible assets for events or changes in circumstances that may indicate that the carrying amount of the assets may not be recoverable. Based on those reviews, adjustments of recorded amounts have not been required.

Non-marketable Equity Investments The Company accounts for non-marketable equity investments, in which it holds less than a 20% ownership, under the cost method. Under the cost method of accounting, investments are carried at cost and are adjusted only for other than temporary declines in fair value, distributions of earnings and additional investments. The Company periodically evaluates whether any declines in fair value of its investments are other than temporary. In performing this evaluation, the Company considers various factors including any decline in market price, where available, the investee's financial condition, results of operations, operating trends and other financial ratios. Non-marketable equity investments are included in other assets on the consolidated balance sheets.

Foreclosed Assets Real estate acquired as a result of foreclosure is initially recorded at fair value less estimated selling costs. Fair value is generally determined through the receipt of appraisals. Any write down to fair value at the time the property is acquired is recorded as a charge-off to the allowance for loan losses. Any decline in the fair value of the property subsequent to acquisition is recorded as a charge to non-interest expense.

Treasury Stock Purchases of the Company s common stock are recorded at cost. Upon reissuance, treasury stock is reduced based upon the average cost basis of shares held.

Comprehensive Income Comprehensive income consists of net income, changes in net unrealized gains (losses) on available-for-sale securities and pension liability adjustments and is presented in the accompanying consolidated statements of shareholders' equity and consolidated statements of comprehensive income.

Loans Interest on loans is recognized based upon the principal amounts outstanding. It is the Company s policy to discontinue the accrual of interest when there is reasonable doubt as to the collectability of principal or interest. Subsequent payments received on such loans are applied to principal if there is any doubt as to the collectability of such principal; otherwise, these receipts are recorded as interest income. The accrual of interest on a loan is resumed when the loan is current as to payment of both principal and interest and/or the borrower demonstrates the ability to pay and remain current. Loan origination and commitment fees on originated loans, net of certain direct loan origination costs, are deferred and amortized to interest income using the level-yield method over the estimated lives of the related loans.

Impairment of Loans A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due, both principal and interest, according to the contractual terms of the loan agreement. When measuring impairment, the expected future cash flows of an impaired loan are discounted at the loan's effective interest rate. Alternatively, impairment could be measured by reference to an observable market price, if one exists, or the fair value of the collateral for a collateral-dependent loan. Regardless of the historical measurement method used, the Company measures impairment based on the fair value of the collateral when the Company determines foreclosure is probable. Additionally, impairment of a restructured loan is measured by discounting the total expected future cash flows at the loan's effective rate of interest as stated in the original loan agreement. The Company uses its nonaccrual methods as discussed above for recognizing interest on impaired loans.

Information Services Revenue A majority of the Company s revenues are attributable to fees for providing services. These services include transportation invoice rating, payment processing, auditing, and the generation of accounting and transportation information. The Company also processes, pays and generates management information from electric, gas, telecommunications, environmental, and other invoices. The specific payment and information processing services provided to each customer are developed individually to meet each customer s specific requirements. The Company enters into service agreements with customers typically for fixed fees per transaction that are invoiced monthly. Revenues are recognized in the period services are rendered and earned under the service agreements, as long as collection is reasonably assured.

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Income Taxes Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. Deferred tax assets are reduced if necessary, by a deferred tax asset valuation allowance. In the event that management determines it is more likely than not that it will not be able to realize all or part of net deferred tax assets in the future, the Company adjusts the recorded value of deferred tax assets, which would result in a direct charge to income tax expense in the period that such determination is made. Likewise, the Company will reverse the valuation allowance when realization of the deferred tax asset is expected. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Earnings Per Share Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the sum of the weighted average number of common shares outstanding and the weighted average number of potential common shares outstanding.

Stock-Based Compensation The Company follows FASB ASC 718 - *Accounting for Stock Options and Other Stock-based Compensation* (ASC 718), which requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award. FASB ASC 718 also requires that excess tax benefits related to stock option exercises and restricted stock awards be reflected as financing cash inflows instead of operating cash inflows.

Pension Plans The amounts recognized in the consolidated financial statements related to pension are determined from actuarial valuations. Inherent in these valuations are assumptions including expected return on plan assets, discount rates at which the liabilities could be settled at December 31, 2016, rate of increase in future compensation levels and mortality rates. These assumptions are updated annually and are disclosed in Note 10. The Company follows FASB ASC 715 - *Compensation Retirement Benefits* (ASC 715), which requires companies to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its consolidated balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation as of the date of its fiscal year-end.

Fair Value Measurements The Company follows the provisions of FASB ASC 820 - *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value in GAAP, and outlines disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A three-level hierarchy for valuation techniques is used to measure financial assets and financial liabilities at fair value. This hierarchy is based on whether the valuation inputs are observable or unobservable. Financial instrument valuations are considered Level 1 when they are based on quoted prices in active markets for identical assets or liabilities. Level 2 financial instrument valuations use 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. Financial instrument valuations are considered Level 3 when they are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable, and when determination of the fair value requires significant management judgment or estimation. The Company records securities available for sale at their fair values on a recurring basis using Level 2 valuations. Additionally, the Company records impaired loans and other real estate owned at their fair value on a nonrecurring basis. The nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or impairment write-downs of individual assets.

Impact of New and Not Yet Adopted Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09 *Revenue from Contracts with Customers*. The ASU supersedes revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance identifies specific steps that entities should apply in order to achieve this principle. Under the ASU, the amendments are effective for interim and annual periods beginning January 1, 2018 and must be applied retrospectively. The impact of the adoption of this ASU is currently being evaluated but is not expected to have a material impact on the Company s consolidated financial statements or results of operations.

In February 2016, the FASB issued ASU No. 2016-02 *Leases (ASC Topic 842)*. The ASU improves financial reporting about leasing transactions. The ASU affects all companies and other organizations that lease assets such as real estate, airplanes, and manufacturing equipment. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP which requires only capital leases to be recognized on the balance sheet the new ASU will require both types of leases to be recognized on the balance sheet. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The ASU will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The impact of the adoption of this ASU is currently being evaluated but is not expected to have a material impact on the Company s consolidated financial statements or results of operations.

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In March 2016, the FASB issued ASU No. 2016-09 *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The ASU will simplify the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This standard is effective for fiscal periods beginning after December 15, 2016. The impact of the adoption of this ASU is currently being evaluated.

In June 2016, the FASB issued ASU No. 2016-13 - *Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The ASU requires measurement and recognition of expected credit losses for financial assets held. Under this standard, a company will be required to hold an allowance equal to the expected life-of-loan losses on the loan portfolio. The standard is effective for fiscal periods beginning after December 15, 2019. The impact of the adoption of this ASU is currently being evaluated.

Note 2
Capital Requirements and Regulatory Restrictions

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company s consolidated financial statements. Under capital adequacy guidelines, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company s and the Bank s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulators to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier I capital and common equity Tier I capital to risk-weighted assets, and of Tier I capital to average assets. Management believes that as of December 31, 2016 and 2015, the Company and the Bank met all capital adequacy requirements to which they are subject.

Effective July 2, 2013, the Federal Reserve Board approved final rules known as the Basel III Capital Rules that substantially revise the risk-based capital and leverage capital requirements applicable to bank holding companies and depository institutions, including the Company and the Bank. The Basel III Capital Rules implement aspects of the Basel III capital framework agreed upon by the Basel Committee and incorporate changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Among other things, the Basel III Capital Rules establish stricter capital requirements and calculation standards, as well as more restrictive risk weightings for certain loans and facilities. The Basel III Capital Rules were effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period).

The Bank is also subject to the regulatory framework for prompt corrective action. As of December 31, 2016, the most recent notification from the regulatory agencies categorized the Bank as well-capitalized. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, common equity Tier I risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank s category.

Subsidiary dividends can be a significant source of funds for payment of dividends by the Company to its shareholders. At December 31, 2016, unappropriated retained earnings of $26,374,000 were available at the Bank for the declaration of dividends to the Company without prior approval from regulatory authorities. However, dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank s capital to be reduced below applicable minimum capital requirements.

There were no restricted funds on deposit used to meet regulatory reserve requirements at December 31, 2016 and 2015.

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The Company s and the Bank s actual and required capital amounts and ratios are as follows:

(In thousands)	Actual Amount	Actual Ratio	Capital Requirements Amount	Capital Requirements Ratio	Requirement to be Well-Capitalized Amount	Requirement to be Well-Capitalized Ratio
At December 31, 2016						
Total capital (to risk-weighted assets)						
Cass Information Systems, Inc.	$ 219,747	22.75%	$ 77,272	8.00%	$ N/A	N/A %
Cass Commercial Bank	110,576	16.72	52,898	8.00	66,123	10.00
Common Equity Tier I Capital (to risk-weighted assets)						
Cass Information Systems, Inc.	209,572	21.70	43,466	4.50	N/A	N/A
Cass Commercial Bank	102,769	15.54	29,755	4.50	42,980	6.50
Tier I capital (to risk-weighted assets)						
Cass Information Systems, Inc.	209,572	21.70	57,954	6.00	N/A	N/A
Cass Commercial Bank	102,769	15.54	39,674	6.00	52,898	8.00
Tier I capital (to average assets)						
Cass Information Systems, Inc.	209,572	13.83	60,620	4.00	N/A	N/A
Cass Commercial Bank	102,769	13.98	29,409	4.00	36,761	5.00
At December 31, 2015						
Total capital (to risk-weighted assets)						
Cass Information Systems, Inc.	$ 212,717	23.31%	$ 72,994	8.00%	$ N/A	N/A %
Cass Commercial Bank	99,872	16.90	47,281	8.00	59,102	10.00
Common Equity Tier I Capital (to risk-weighted assets)						
Cass Information Systems, Inc.	201,312	22.06	41,059	4.50	N/A	N/A
Cass Commercial Bank	92,470	15.65	26,596	4.50	38,416	6.50
Tier I capital (to risk-weighted assets)						
Cass Information Systems, Inc.	201,312	22.06	54,746	6.00	N/A	N/A
Cass Commercial Bank	92,470	15.65	35,461	6.00	47,281	8.00
Tier I capital (to average assets)						