

FNCB Bancorp, Inc.
Form 10-K
March 10, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2016

OR

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

For the transition period from to

Commission File No. 000-53869

FNCB BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania

(State or Other Jurisdiction of Incorporation or Organization)

23-2900790

(I.R.S. Employer Identification No.)

102 E. Drinker St., Dunmore, PA

(Address of Principal Executive Offices)

18512

(Zip Code)

Registrant's telephone number, including area code **(570) 346-7667**

Securities registered pursuant to Section 12(b) of the Act: **NONE**

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

Common Stock, \$1.25 par value

(Title of Class)

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 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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller reporting company

(Do not check if a 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 voting and non-voting common stock of the registrant, held by non-affiliates was \$80,096,019 at June 30, 2016.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

State the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 16,661,978 shares of common stock as of March 10, 2017.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Items 10, 11, 12, 13 and 14 is incorporated by reference into Part III hereof from portions of the Proxy Statement for the registrant's 2017 Annual Meeting of Shareholders.

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PART I

Item 1. Business

Overview

The Company

FNCB Bancorp, Inc., formerly First National Community Bancorp, Inc., incorporated in 1997, is a Pennsylvania business corporation and a registered bank holding company headquartered in Dunmore, Pennsylvania. FNCB Bancorp, Inc. became an active bank holding company on July 1, 1998 when it acquired 100% ownership of the former First National Community Bank. In this report, the terms “FNCB,” “we,” “us,” and “our” refer to FNCB Bancorp, Inc. and its subsidiaries, unless the context requires otherwise. In certain circumstances, however, FNCB Bancorp, Inc. uses the term “FNCB” to refer to itself.

Effective June 30, 2016, following receipt of required regulatory approvals from the Pennsylvania Department of Banking and Securities, First National Community Bank completed a charter conversion from a national bank to a Pennsylvania state bank. Following the change in charter, First National Community Bank changed its legal name to FNCB Bank (the “Bank”). Subsequently, on October 4, 2016, the holding company filed an amendment to its articles of incorporation to change its name, effective October 17, 2016, from First National Community Bancorp, Inc. to FNCB Bancorp, Inc.

FNCB’s primary activity consists of owning and operating the Bank, which provides substantially all of FNCB’s earnings as a result of its banking services.

FNCB had net income of \$6.3 million, \$35.8 million and \$13.4 million in 2016, 2015 and 2014, respectively. Total assets were \$1.2 billion at December 31, 2016, \$1.1 billion at December 31, 2015 and \$1.0 billion at December 31, 2014.

The Bank

Established as a national banking association in 1910, as of December 31, 2016 the Bank operated 19 full-service branch offices within three contiguous counties, Lackawanna, Luzerne and Wayne, its primary market area located in the Northeast section of Pennsylvania.

On January 6, 2017, the Bank notified the Pennsylvania Department of Banking and Securities and FNCB's federal banking regulators of its intent to open a limited purpose office ("LPO") in Allentown, Lehigh County, Pennsylvania. The Pennsylvania Department of Banking and Securities issued a non-objection letter to the Bank on February 22, 2017 regarding the establishment of the Allentown-based LPO.

Products and Services

Retail Banking

The Bank provides a wide variety of traditional banking products and services to individuals and businesses, including online, mobile and telephone banking, debit cards, check imaging and electronic statements. Deposit products include various checking, savings and certificate of deposit products, as well as a line of preferred products for higher-balance customers. The Bank is a member of the Promontory Interfinancial Network and participates in their Certificate of Deposit Account Registry ("CDARs") and Insured Cash Sweep ("ICS") programs, which allow customers to secure Federal Deposit Insurance Corporation ("FDIC") insurance on balances in excess of the standard limitations.

The Bank also offers customers the convenience of 24-hour banking, seven days a week, through FNCB Online Banking ("FNCB Online") and FNCB Business Online Banking via a secure website, <https://www.fncb.com>. FNCB's online product suite includes Bill Payment, Internal and External Funds Transfer and POP Money (person to person transfers), and Purchase Rewards. Through FNCB Online, customers can directly access their accounts, open new accounts and apply for a mortgage or obtain a pre-qualification approval through the Bank's mortgage center. Customers can also access FNCB Online through the Bank's mobile application. Telephone banking ("Account Link"), a service that provides customers with the ability to access account information and perform related account transfers through the use of a touch tone telephone, is also available. In addition, customers can access money from their deposit accounts by using their debit card to make purchases or withdraw cash from any automated teller machines ("ATMs") including ATMs located in each of the Bank's branch offices as well as additional locations. FNCB's mobile deposit, available to personal banking customers with access to FNCB Online and an eligible deposit account, allows customers to deposit checks, electronically from start to finish, from anywhere at any time.

FNCB Business Online Banking is a menu driven product that provides the Bank's business customers direct access to their account information and the ability to perform internal and external transfers, wire transfers and payments through ACH transactions, and process Direct Deposit payroll transactions for employees, 24 hours a day, 7 days a week, from their place of business. Remote Deposit Capture allows business customers the ability to process daily check deposits to their accounts through an online image capture environment. Business customers can access money from their deposit account by using their "business" debit card, providing a faster, more convenient way to make purchases, track business expenses and manage finances.

The Bank offers several overdraft protection products including, Bounce Protection, Instant Money and transfer from another FNCB checking or savings account, which provide customers with an added level of protection against unanticipated overdrafts due to cash flow emergencies and account reconciliation errors. The Bank offers its customers an identity theft protection plan through a strategic partnership with an independent vendor. Subscribers select which coverage package they desire by visiting the Bank's secure website and choosing "Identity Protection" from the Resources menu.

Lending Activities

FNCB offers a variety of loans, including residential real estate loans, construction, land acquisition and development loans, commercial real estate loans, commercial and industrial loans, loans to state and political subdivisions, and consumer loans, generally to individuals and businesses in its primary market area. These lending activities are described in further detail below.

Residential Mortgage Loans

FNCB offers a variety of fixed-rate one- to four-family residential loans including First Time Homebuyer mortgages, FHA and Home Possible® mortgages to meet the home financing needs of customers with low down payments. FNCB also offers a "WOW" mortgage, a first-lien, fixed-rate mortgage product with maturity terms ranging from 7.5 to 14.5 years. At December 31, 2016, one- to four-family residential mortgage loans totaled \$144.3 million, or 19.7%, of the total loan portfolio. Except for the WOW mortgage, one- to four-family mortgage loans are originated generally for sale in the secondary market. However, FNCB may hold in portfolio one- to four-family residential mortgage loans as deemed necessary according to current asset/liability management strategies. During the year ended December 31, 2016, the Bank sold \$9.5 million of one- to four-family mortgages. FNCB retains servicing rights on these mortgages.

Construction, Land Acquisition and Development Loans

FNCB offers interim construction financing secured by residential property for the purpose of constructing one- to four-family homes. FNCB also offers interim construction financing for the purpose of constructing residential developments and various commercial properties including shopping centers, office complexes and single purpose owner-occupied structures and for land acquisition. At December 31, 2016, construction, land acquisition and development loans amounted to \$18.4 million and represented 2.5% of the total loan portfolio.

Commercial Real Estate Loans

Commercial real estate mortgage loans represent the largest portion of FNCB's total loan portfolio and loans in this portfolio generally have larger loan balances. These loans are secured by a broad range of real estate, including but not limited to, office complexes, shopping centers, hotels, warehouses, gas stations, convenience markets, residential care facilities, nursing care facilities, restaurants, multifamily housing, farms and land subdivisions. At December 31, 2016, FNCB's commercial real estate loans totaled \$243.8 million, or 33.3%, of the total loan portfolio.

Commercial and Industrial Loans

FNCB generally offers commercial loans to sole proprietors and businesses located in its primary market area. The commercial loan portfolio includes, but is not limited to, lines of credit, dealer floor plan lines, equipment loans, vehicle loans and term loans. These loans are primarily secured by vehicles, machinery and equipment, inventory, accounts receivable, marketable securities and deposit accounts. At December 31, 2016, FNCB's commercial and industrial loans totaled \$153.8 million, or 21.0%, of the total loan portfolio.

Consumer Loans

Consumer loans include both secured and unsecured installment loans, lines of credit and overdraft protection loans. The Bank is also in the business of underwriting indirect auto loans which are originated through various auto dealers in its market area and dealer floor plan loans. FNCB also offers home equity loans and lines of credit with a maximum combined loan-to-value ratio of 90%, based on the appraised value of the property. Home equity loans have fixed rates of interest and are for terms up to 15 years. Home equity lines of credit have adjustable interest rates and are based on the prime interest rate. At December 31, 2016, FNCB's consumer loans totaled \$127.8 million, or 17.5%, of the total loan portfolio.

State and Political Subdivision Loans

FNCB originates state and political subdivision loans, including general obligation and tax anticipation notes, primarily to municipalities in the Bank's market area. At December 31, 2016, FNCB's state and political subdivision loans totaled \$43.7 million, or 6.0%, of the total loan portfolio.

For more information regarding FNCB's loan portfolio and lending policies, please refer to Note 2, "Summary of Significant Accounting Policies" to the consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Wealth Management

FNCB offers customers wealth management services through a third party provider. Customers are able to access alternative deposit products such as mutual funds, annuities, stocks, and bonds directly for purchase from an outside provider.

Deposit Activities

In general, deposits, borrowings and loan repayments are the major sources of funding for lending and other investment purposes. FNCB relies primarily on marketing, product innovation, technology and service to attract, grow and retain its deposits. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of deposit accounts, management considers the interest rates offered by its competitors, the interest rates available on borrowings, its liquidity needs and customer preferences. Management regularly reviews FNCB's deposit mix and deposit pricing as part of its asset/liability management, taking into consideration rates offered by competitors in its market area.

Competition

FNCB faces substantial competition in originating loans and in attracting deposits from a significant number of financial institutions operating in its market area, many with a statewide or regional presence, and in some cases, a national presence, as well as other financial institutions outside of its market area through online loan and deposit product offerings. The competition comes principally from other banks, savings institutions, credit unions, mortgage

banking companies and, with respect to deposits, institutions offering investment alternatives, including money market funds and online deposit accounts. The increased competition has resulted from changes in the legal and regulatory guidelines, as well as from economic conditions. The cost of regulatory compliance remains high for community banks as compared to their larger competitors that are able to achieve economies of scale.

As a result of consolidation in the banking industry, some of the Bank's competitors and their respective affiliates are larger and may enjoy advantages such as greater financial resources, a wider geographic presence, a wider array of services, or more favorable pricing alternatives and lower origination and operating costs. FNCB considers its major competition to be local commercial banks as well as other commercial banks with branches in its market area. Competitors may offer deposits at higher rates and loans with lower fixed rates, more attractive terms and less stringent credit structures than FNCB has been able to offer. The growth and profitability of FNCB depends on its continued ability to successfully compete.

Supervision and Regulation

FNCB participates in a highly regulated industry and is subject to a variety of statutes, regulations and policies, as well as ongoing regulatory supervision and review. These laws, regulations and policies are subject to frequent change and FNCB takes measures to comply with applicable requirements.

FNCB

FNCB is a bank holding company registered with, and subject to regulation by, the Reserve Bank and the Board of Governors of the Federal Reserve System ("FRB"). The Bank Holding Company Act of 1956, as amended (the "BHCA"), and other federal laws subject bank holding companies to restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations and unsafe and unsound banking practices.

The BHCA requires approval of the FRB for, among other things, the acquisition by a proposed bank holding company of control of more than five percent (5%) of the voting shares, or substantially all the assets, of any bank or the merger or consolidation by a bank holding company with another bank holding company. The BHCA also generally permits the acquisition by a bank holding company of control or substantially all the assets of any bank located in a state other than the home state of the bank holding company, except where the bank has not been in existence for the minimum period of time required by state law; but if the bank is at least 5 years old, the FRB may approve the acquisition.

With certain limited exceptions, a bank holding company is prohibited from acquiring control of any voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking or managing or controlling banks or furnishing services to or performing services for its authorized subsidiaries. A bank holding company may, however, engage in, or acquire an interest in a company that engages in, activities that the FRB has determined by order or regulation to be so closely related to banking or managing or controlling banks as to be properly incident thereto. In making such a determination, the FRB is required to consider whether the performance of such activities can reasonably be expected to produce benefits to the public, such as convenience, increased competition or gains in efficiency, which outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The FRB is also empowered to differentiate between activities commenced *de novo* and activities commenced by the acquisition, in whole or in part, of a going concern. Some of the activities that the FRB has determined by regulation to be closely related to banking include making or servicing loans, performing certain data processing services, acting as a fiduciary or investment or financial advisor, and making investments in corporations or projects designed primarily to promote community welfare.

Subsidiary banks of a bank holding company are subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or any of its subsidiaries, or investments in the stock or other securities thereof, and on the taking of such stock or securities as collateral for loans to any borrower. Further, a holding company and any subsidiary bank are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit. A subsidiary bank may not extend credit, lease or sell property, or furnish any services, or fix or vary the consideration for any of the foregoing on the condition that: (i) the customer obtain or provide some additional credit, property or services from or to such bank other than a loan, discount, deposit or trust service; (ii) the customer obtain or provide some additional credit, property or service from or to the bank holding company or any other subsidiary of the bank holding company; or (iii) the customer not obtain some other credit, property or service from competitors, except for reasonable requirements to assure the soundness of credit extended.

The Gramm Leach-Bliley Act of 1999 (the “GLB Act”) allows a bank holding company or other company to certify status as a financial holding company, which allows such company to engage in activities that are financial in nature, that are incidental to such activities, or are complementary to such activities without further approval. FNCB is not a financial holding company. The GLB Act enumerates certain activities that are deemed financial in nature, such as underwriting insurance or acting as an insurance principal, agent or broker, underwriting, dealing in or making markets in securities, and engaging in merchant banking under certain restrictions. It also authorizes the FRB to determine by regulation what other activities are financial in nature, or incidental or complementary thereto.

FNCB also is subject to the jurisdiction of the Securities and Exchange Commission (“SEC”) and is subject to the disclosure and regulatory requirements under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. The common stock of FNCB trades on the OTCQX marketplace under the symbol “FNCB” and, therefore, FNCB also is subject to the rules and requirements of FINRA for companies with securities trading on the OTCQX.

The Bank

Effective June 30, 2016, upon its conversion to a state charter, the Bank is regulated by the Pennsylvania Department of Banking and Securities. The Bank's deposit accounts are insured up to the maximum legal limit by the Deposit Insurance Fund of the FDIC and accordingly, the Bank is also regulated by the FDIC. The regulations of these agencies and the FDIC govern most aspects of the Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends and location and number of branch offices. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the Deposit Insurance Fund, and not for the purpose of protecting shareholders.

Branching and Interstate Banking. The federal banking agencies are authorized to approve interstate bank merger transactions without regard to whether such transactions are prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act") by adopting a law after the date of enactment of the Riegle-Neal Act and before June 1, 1997 that applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate bank mergers are also subject to the nationwide and statewide insured deposit concentration limitations described in the Riegle-Neal Act.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") permits national and state banks to establish *de novo* branches in other states to the same extent as a bank chartered by that state would be so permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Pennsylvania law had previously permitted banks chartered in Pennsylvania to establish branches in other states without limitation, thereby permitting national banks in Pennsylvania to establish branches anywhere in the state, but only permitted out of state banks to branch in Pennsylvania if the home state of the out-of-state bank permits Pennsylvania banks to establish *de novo* branches. The branching provisions of the Dodd-Frank Act could result in more banks from other states establishing *de novo* branches in the Bank's market area.

USA Patriot Act and the Bank Secrecy Act (“BSA”). Under the BSA, a financial institution is required to have systems in place to detect certain transactions, based on the size and nature of the transaction. Financial institutions are generally required to report cash transactions involving more than \$10,000 to the United States Treasury. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than \$5,000 and that the financial institution knows, suspects or has reason to suspect, involves illegal funds, is designed to evade the requirements of the BSA or has no lawful purpose. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, commonly referred to as the “USA Patriot Act” or the “Patriot Act,” financial institutions are subject to prohibitions against specified financial transactions and account relationships, as well as enhanced due diligence standards intended to detect, and prevent, the use of the United States financial system for money laundering and terrorist financing activities. The Patriot Act requires financial institutions, including banks, to establish anti-money laundering programs, including employee training and independent audit requirements, meet minimum specified standards, follow minimum standards for customer identification and maintenance of customer identification records, and regularly compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers.

Capital Adequacy Requirements. Federal banking agencies have adopted risk based capital adequacy and leverage capital adequacy requirements pursuant to which they assess the adequacy of capital in examining and supervising banks and bank holding companies and in analyzing bank regulatory applications. Risk-based capital requirements determine the adequacy of capital based on the risk inherent in various classes of assets and off-balance sheet items.

The federal banking regulators issued a final rulemaking in July 2013 (the “Basel III Rule”) to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began January 1, 2015, while larger institutions (generally those with assets of \$250 billion or more) began compliance on January 1, 2014. The final rules call for the following capital requirements:

A minimum ratio of common equity tier I (“CET I”) capital to risk-weighted assets of 4.5%.

A minimum ratio of tier I capital to risk-weighted assets of 6%.

A minimum ratio of total capital to risk-weighted assets of 8%.

A minimum leverage ratio of 4%.

Basel III also establishes a “countercyclical capital buffer,” that is designed to absorb losses during periods of economic stress. Generally, the capital conservation buffer of 2.50% of risk-weighted assets, when fully phased in, will be imposed when federal banking regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. For all banking institutions, the phase-in period for the capital conservation buffer requirement began on January 1, 2016 at 0.625% and will increase by that amount each year until it reaches 2.50% on January 1, 2019.

Banking institutions with a ratio of CET I to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) may face constraints on their ability to pay dividends, to effect equity repurchases and pay discretionary bonuses to executive officers, which constraints vary based on the amount of the shortfall.

The Basel III Rule also includes, as part of the definition of CET I capital, a requirement that banking institutions include the amount of Accumulated Other Comprehensive Income (“AOCI”), which primarily consists of unrealized gains and losses, net of tax, on available-for-sale securities, that are not other than temporarily impaired (“OTTI”) in calculating regulatory capital, unless the institution makes a one-time opt-out election from this provision in connection with the filing of its first regulatory reports after applicability of the Basel III Rule to that institution. The Basel III Rule also imposes a 4.00% minimum Tier I leverage ratio.

The Basel III final framework provides for a number of new deductions from and adjustments to CET I. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET I to the extent that any one such category exceeds 10.00% of CET I or all such categories in the aggregate exceed 15.00% of CET I.

The Basel III Rule also makes changes to the manner of calculating risk-weighted assets. It imposes methodologies for determining risk weighted assets, including revisions to recognition of credit risk mitigation, such as a greater recognition of financial collateral and a wider range of eligible guarantors. They also include risk weighting of equity exposures and past due loans; and higher (greater than 100%) risk weighting for certain commercial real estate exposures that have higher credit risk profiles, including higher loan to value and equity components.

As discussed below, the Basel III Rule also integrates the new capital requirements into the prompt corrective action provisions under Section 38 of the Federal Deposit Insurance Act (“FDIA”).

In general, the Basel III Rule became applicable to FNCB and the Bank on January 1, 2015. FNCB and the Bank elected to exclude AOCI in calculating regulatory capital with the filing of their respective first regulatory reports after applicability of the Basel III Rule to them. Additionally, FNCB’s outstanding subordinated notes are subject to phase out and will cease to qualify as capital for regulatory purposes. Overall, FNCB believes that implementation of the Basel III Rule did not have a material adverse effect on its or the Bank’s capital ratios, earnings, shareholder’s equity, or its ability to pay discretionary bonuses to executive officers.

Prompt Corrective Action. Under Section 38 of the FDIA, each federal banking agency is required to implement a system of prompt corrective action for institutions which it regulates. The federal banking agencies have promulgated substantially similar regulations to implement the system of prompt corrective action established by Section 38 of the FDIA.

The following are the capital requirements under the Basel III Rules integrated into the prompt corrective action category definitions. As of December 31, 2016, the following capital requirements were applicable to the Bank for purposes of Section 38 of the FDIA.

Capital Category	Total Risk-Based Capital Ratio	Tier I Risk-Based Capital Ratio	CET I Capital Ratio	Leverage Ratio	Tangible Equity to Assets
Well capitalized	$\geq 10.0\%$	$\geq 8.0\%$	$\geq 6.5\%$	$\geq 5.0\%$	N/A
Adequately capitalized with conervation buffer	$\geq 8.625\%$	$\geq 6.625\%$	$\geq 5.125\%$	$\geq 4.0\%$	N/A
Adequately capitalized	$\geq 8.0\%$	$\geq 6.0\%$	$\geq 4.5\%$	$\geq 4.0\%$	N/A
Undercapitalized	$< 8.0\%$	$< 6.0\%$	$< 4.5\%$	$< 4.0\%$	N/A
Significantly undercapitalized	$< 6.0\%$	$< 4.0\%$	$< 3.0\%$	$< 3.0\%$	N/A
Critically undercapitalized	N/A	N/A	N/A	N/A	Less than 2.0%

At December 31, 2016, FNCB met its capital requirements with a common equity Tier I capital to risk-weighted assets of 9.97%, a Tier I capital to risk-weighted assets ratio of 10.23%, a Total capital to risk-weighted assets ratio of 12.06%, and a Leverage ratio of 7.53%.

Regulatory Enforcement Authority. Federal banking law grants substantial enforcement powers to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and

institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

The Bank and its “institution-affiliated parties,” including its management, employees, agents, independent contractors, consultants such as attorneys and accountants and others who participate in the conduct of the financial institution’s affairs, are subject to potential civil and criminal penalties for violations of law, regulations or written orders of a governmental agency. In addition, regulators are provided with greater flexibility to commence enforcement actions against institutions and institution-affiliated parties. Possible enforcement actions include the termination of deposit insurance and cease-and-desist orders. Such orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions as determined by the ordering agency to be appropriate.

Under provisions of the federal securities laws, a determination by a court or regulatory agency that certain violations have occurred at a company or its affiliates can result in fines, restitution, a limitation of permitted activities, disqualification to continue to conduct certain activities and an inability to rely on certain favorable exemptions. Certain types of infractions and violations can also affect a public company in its timing and ability to expeditiously issue new securities into the capital markets.

The 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 the classification of assets and the establishment of adequate loan loss allowances for regulatory purposes.

As a result of the previous volatility and instability in the financial system, Congress, the bank regulatory authorities and other government agencies have called for or proposed additional regulation and restrictions on the activities, practices and operations of banks and their holding companies. While many of these proposals relate to institutions that have accepted investments from, or sold troubled assets to, the United States Department of the Treasury (“Treasury Department”) or other government agencies, or otherwise participate in government programs intended to promote financial stabilization, Congress and the federal banking agencies have broad authority to require all banks and holding companies to adhere to more rigorous or costly operating procedures, corporate governance procedures, or to engage in activities or practices which they might not otherwise elect. Any such requirement could adversely affect FNCB’s business and results of operations. FNCB did not accept an investment by the Treasury Department in its preferred stock or warrants to purchase common stock, and except for the increase in deposit insurance for customer accounts, has not participated in any of the programs adopted by the Treasury Department, FDIC or FRB.

The Dodd-Frank Act. The Dodd-Frank Act made significant changes to the bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act has required a number of federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. The federal agencies have been given significant discretion in drafting these rules and regulations. To date, the following provisions of the Dodd-Frank Act are considered to be of greatest significance to FNCB:

expands the authority of the FRB to examine bank holding companies and their subsidiaries, including insured depository institutions;

requires a bank holding company to be well capitalized and well managed to receive approval of an interstate bank acquisition;

changes standards for federal preemption of state laws related to national banks and their subsidiaries;

provides mortgage reform provisions regarding a customer’s ability to pay and making more loans subject to provisions for higher-cost loans and new disclosures;

creates the Consumer Financial Protection Bureau (the “CFPB”) that has rulemaking authority for a wide range of consumer protection laws that apply to all banks and has broad powers to supervise and enforce consumer protection laws;

creates the Financial Stability Oversight Council with authority to identify institutions and practices that might pose a systemic risk;

introduces additional corporate governance and executive compensation requirements on companies subject to the Securities and Exchange Act of 1934, as amended;

permits FDIC-insured banks to pay interest on business demand deposits;

requires that holding companies and other companies that directly or indirectly control an insured depository institution serve as a source of financial strength;

makes permanent the \$250 thousand limit for federal deposit insurance at all insured depository institutions; and

permits national and state banks to establish interstate branches to the same extent as the branch host state allows establishment of in-state branches.

President Donald J. Trump has indicated that one of the goals of his administration is to reduce federal government regulation, including, among other things, reconsidering certain regulations promulgated under the Dodd-Frank Act. On February 3, 2017, President Trump issued an executive order that directs the Secretary of the Treasury Department to consult with the heads of the member agencies of the Financial Stability Oversight Council and report to President Trump on the extent to which the laws and regulations governing the U.S. financial system are in accord with certain enumerated “core principles” (the “Executive Order”). The “core principles” set forth in the Executive Order relate to U.S. financial system regulation, and include fostering economic growth and vibrant financial markets through more rigorous regulatory impact analysis, and making “regulation more efficient, effective and appropriately tailored.” Given the recent nature of this Trump Administration initiative, at this time, FNCB cannot determine what existing provisions of and regulations under the Dodd-Frank Act, if any, will be repealed or modified, or what impact, if any, the effect of the Trump Administration’s initiative may have on FNCB, its business or future results of operations.