
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

Form 10-Q

- ☒ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended September 30, 2017
or
☐ Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
for the transition period from
001-36388
(Commission File Number)
-

PEOPLES FINANCIAL SERVICES CORP.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State of
incorporation)

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

23-2391852
(IRS Employer
ID Number)

18503
(Zip code)

(570) 346-7741
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically 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 during the preceding 12 months or for such shorter period that the registrant was required to submit and post such files. Yes ☒ No ☐

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of the registrant's common stock, as of the latest practicable date: 7,396,505 at October 31, 2017.

PEOPLES FINANCIAL SERVICES CORP.
FORM 10-Q

For the Quarter Ended September 30, 2017

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Peoples Financial Services Corp.
CONSOLIDATED BALANCE SHEET S (UNAUDITED)
(Dollars in thousands, except share and per share data)

	<u>September 30, 2017</u>	<u>December 31, 2016</u>
Assets:		
Cash and due from banks:		
Cash and due from banks	\$ 31,839	\$ 39,496
Interest-bearing deposits in other banks	1,067	445
Total cash and due from banks	<u>32,906</u>	<u>39,941</u>
Investment securities:		
Available-for-sale	259,138	259,410
Held-to-maturity: Fair value September 30, 2017, \$9,912; December 31, 2016, \$10,714	9,564	10,517
Total investment securities	<u>268,702</u>	<u>269,927</u>
Loans, net	1,632,515	1,532,965
Less: allowance for loan losses	<u>18,831</u>	<u>15,961</u>
Net loans	1,613,684	1,517,004
Loans held for sale	460	
Premises and equipment, net	37,373	33,260
Accrued interest receivable	5,908	6,228
Goodwill	63,370	63,370
Intangible assets, net	3,427	4,211
Other assets	66,406	65,501
Total assets	<u>\$ 2,092,236</u>	<u>\$ 1,999,442</u>
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 372,146	\$ 353,686
Interest-bearing	<u>1,315,709</u>	<u>1,235,071</u>
Total deposits	1,687,855	1,588,757
Short-term borrowings	71,900	82,700
Long-term debt	50,199	58,134
Accrued interest payable	481	462
Other liabilities	<u>15,505</u>	<u>12,771</u>
Total liabilities	<u>1,825,940</u>	<u>1,742,824</u>
Stockholders' equity:		
Common stock, par value \$2.00, authorized 25,000,000 shares, issued and outstanding 7,396,505 shares at September 30, 2017 and 7,394,143 shares at December 31, 2016	14,793	14,788
Capital surplus	134,988	134,871
Retained earnings	119,971	111,114
Accumulated other comprehensive loss	<u>(3,456)</u>	<u>(4,155)</u>
Total stockholders' equity	<u>266,296</u>	<u>256,618</u>
Total liabilities and stockholders' equity	<u>\$ 2,092,236</u>	<u>\$ 1,999,442</u>

See notes to unaudited consolidated financial statements

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

September 30,	Three Months Ended		Nine Months Ended	
	2017	2016	2017	2016
Interest income:				
Interest and fees on loans:				
Taxable	\$ 16,535	\$ 15,294	\$ 48,021	\$ 44,400
Tax-exempt	813	770	2,334	2,301
Interest and dividends on investment securities:				
Taxable	714	575	2,130	1,879
Tax-exempt	716	861	2,262	2,611
Dividends	13	10	37	31
Interest on interest-bearing deposits in other banks	40	15	107	47
Total interest income	18,831	17,525	54,891	51,269
Interest expense:				
Interest on deposits	1,654	1,356	4,617	3,961
Interest on short-term borrowings	177	116	599	282
Interest on long-term debt	344	353	1,041	1,067
Total interest expense	2,175	1,825	6,257	5,310
Net interest income	16,656	15,700	48,634	45,959
Provision for loan losses	1,200	1,200	3,600	3,600
Net interest income after provision for loan losses	15,456	14,500	45,034	42,359
Noninterest income:				
Service charges, fees and commissions	2,156	1,542	5,410	4,513
Merchant services income	165	1,257	2,358	3,209
Commission and fees on fiduciary activities	540	539	1,542	1,495
Wealth management income	414	271	1,081	979
Mortgage banking income	193	217	576	616
Life insurance investment income	193	199	577	594
Net gain on sale of investment securities available-for-sale				623
Net gain on sale of merchant services business			2,278	
Total noninterest income	3,661	4,025	13,822	12,029
Noninterest expense:				
Salaries and employee benefits expense	6,550	5,466	19,851	16,702
Net occupancy and equipment expense	2,483	2,316	7,327	6,998
Merchant services expense	33	890	1,796	2,270
Amortization of intangible assets	259	297	785	899
Other expenses	3,155	3,048	9,079	8,879
Total noninterest expense	12,480	12,017	38,838	35,748
Income before income taxes	6,637	6,508	20,018	18,640
Income tax expense	1,287	1,390	4,209	3,785
Net income	5,350	5,118	15,809	14,855
Other comprehensive income:				
Unrealized (loss) gain on investment securities available-for-sale	(381)	(1,120)	1,076	1,003
Reclassification adjustment for net gain on sales included in net income				(623)
Other comprehensive (loss) income	(381)	(1,120)	1,076	380
Income tax related to other comprehensive (loss) income	(133)	(392)	377	133
Other comprehensive (loss) income, net of income taxes	(248)	(728)	699	247
Comprehensive income	\$ 5,102	\$ 4,390	\$ 16,508	\$ 15,102
Per share data:				
Net income:				
Basic	\$ 0.72	\$ 0.69	\$ 2.14	\$ 2.01
Diluted	\$ 0.72	\$ 0.69	\$ 2.14	\$ 2.01
Average common shares outstanding:				
Basic	7,396,505	7,394,143	7,395,612	7,397,581
Diluted	7,396,505	7,394,143	7,395,612	7,397,581
Dividends declared	\$ 0.32	\$ 0.31	\$ 0.94	\$ 0.93

See notes to unaudited consolidated financial statements

Peoples Financial Services Corp.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands, except share and per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2017	\$ 14,788	\$ 134,871	\$ 111,114	\$ (4,155)	\$ 256,618
Stock based compensation		122			122
Net income			15,809		15,809
Other comprehensive income, net of income taxes				699	699
Dividends declared: \$0.94 per share			(6,952)		(6,952)
Common stock grants awarded, net of unearned compensation of \$53: 2,362 shares	5	(5)			
Balance, September 30, 2017	<u>\$ 14,793</u>	<u>\$ 134,988</u>	<u>\$ 119,971</u>	<u>\$ (3,456)</u>	<u>\$ 266,296</u>
Balance, January 1, 2016	\$ 14,821	\$ 135,371	\$ 100,701	\$ (2,125)	\$ 248,768
Stock based compensation		53			53
Net income			14,855		14,855
Other comprehensive income, net of income taxes				247	247
Dividends declared: \$0.93 per share			(6,879)		(6,879)
Shares retired: 16,463 shares	(33)	(571)			(604)
Balance, September 30, 2016	<u>\$ 14,788</u>	<u>\$ 134,853</u>	<u>\$ 108,677</u>	<u>\$ (1,878)</u>	<u>\$ 256,440</u>

See notes to unaudited consolidated financial statements

Peoples Financial Services Corp.
CONSOLIDATED STATEMENTS OF CASH FLOW S (UNAUDITED)
(Dollars in thousands)

For the Nine Months Ended September 30,	2017	2016
Cash flows from operating activities:		
Net income	\$ 15,809	\$ 14,855
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	1,401	1,208
Amortization of deferred loan costs	662	575
Amortization of intangibles	785	899
Amortization of loss on investment tax credits	352	358
Provision for loan losses	3,600	3,600
Net gain on sale of other real estate owned	(50)	(25)
Loans originated for sale	(16,927)	(17,432)
Proceeds from sale of loans originated for sale	16,622	17,688
Net gain on sale of loans originated for sale	(155)	(616)
Net amortization of investment securities	2,130	2,826
Net gain on sale of investment securities available-for-sale		(623)
Net gain on sale of merchant services business	(2,278)	
Life insurance investment income	(577)	(594)
Stock based compensation	122	53
Net change in:		
Accrued interest receivable	320	487
Other assets	(1,780)	(1,799)
Accrued interest payable	19	(126)
Other liabilities	2,665	(671)
Net cash provided by operating activities	<u>22,720</u>	<u>20,663</u>
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale		27,408
Proceeds from repayments of investment securities:		
Available-for-sale	44,489	42,277
Held-to-maturity	936	1,221
Purchases of investment securities:		
Available-for-sale	(45,254)	(36,462)
Net redemption (purchase) of restricted equity securities	710	(1,508)
Net increase in lending activities	(101,320)	(183,482)
Investment in low income housing investment tax credits		(2,045)
Purchases of premises and equipment	(5,514)	(6,100)
Purchase of investment in life insurance		(1,500)
Proceeds from the sale of merchant services business	2,300	
Proceeds from sale of other real estate owned	487	702
Net cash used in investing activities	<u>(103,166)</u>	<u>(159,489)</u>
Cash flows from financing activities:		
Net increase in deposits	99,098	110,000
Repayment of long-term debt	(7,935)	(1,669)
Net (decrease) increase in short-term borrowings	(10,800)	36,975
Retirement of common stock		(604)
Cash dividends paid	(6,952)	(6,879)
Net cash provided by financing activities	<u>73,411</u>	<u>137,823</u>
Net decrease in cash and cash equivalents	<u>(7,035)</u>	<u>(1,003)</u>
Cash and cash equivalents at beginning of period	<u>39,941</u>	<u>32,917</u>
Cash and cash equivalents at end of period	<u>\$ 32,906</u>	<u>\$ 31,914</u>

Peoples Financial Services Corp.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (Continued)
(Dollars in thousands)

For the Nine Months Ended September 30,	2017	2016
Supplemental disclosures:		
Cash paid during the period for:		
Interest	\$ 6,238	\$ 5,436
Income taxes	4,100	3,900
Noncash items:		
Transfers of loans to other real estate	\$ 479	\$ 761

See notes to unaudited consolidated financial statements

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

1. Summary of significant accounting policies:

Nature of operations:

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

Basis of presentation:

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. All significant intercompany balances and transactions have been eliminated in consolidation. Prior-period amounts are reclassified when necessary to conform to the current year's presentation. These reclassifications did not have any effect on the operating results or financial position of the Company. The operating results and financial position of the Company for the three and nine months ended and as of September 30, 2017, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly susceptible to material change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, the valuation of deferred tax assets, determination of other-than-temporary impairment losses on securities, impairment of goodwill and fair value of assets acquired and liabilities assumed in business combinations. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, reference is made to the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Derivative instruments and hedging activities

The Financial Accounting Standards Board ("FASB") ASC 815, *Derivatives and Hedging* ("ASC 815"), provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company's objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

As required by ASC 815, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Currently, none of the Company's derivatives are designated in qualifying hedging relationships, as the derivatives are not used to manage risks within the Company's assets or liabilities. As such, all changes in fair value of the Company's derivatives are recognized directly in earnings.

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

In accordance with the FASB's fair value measurement guidance in ASU 2011-04, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Recent accounting standards:

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The updated standard is a new comprehensive revenue recognition model that requires revenue to be recognized in a manner that depicts the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year. During 2016, the FASB issued ASU Nos. 2016-10, 2016-12 and 2016-20 that provide additional guidance related to the identification of performance obligations within a contract, assessing collectability, contract costs, and other technical corrections and improvements. ASU 2014-09 will become effective for the Company for the annual period beginning after December 15, 2017 and for interim periods within the annual period. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. The Company has not selected a transition method. However, the Company's revenue is comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. Based on the Company's analysis of the effect of the new standard on its recurring revenue streams, it does not expect these changes to have a significant impact on the Company's financial statements. Upon adoption on January 1, 2018, no significant adjustment to opening retained earnings is expected.

In January 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-01, "Financial Instruments – Overall." The guidance in this ASU among other things, (1) requires equity investments with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (3) eliminates the requirement for public businesses entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (4) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (5) requires an entity to present separately in other comprehensive income the portion of the change in fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (6) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (7) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. The guidance in this ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is in the process of evaluating the impact of the adoption of this guidance on the Company's financial statements but due to the nature of the Company's investments it is not expected to have a significant impact, if any.

In February 2016, the FASB issued ASU No. 2016-02, "Leases". From the lessee's perspective, the new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessee. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company's initial findings conclude that the new

Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

pronouncement will not have a significant impact on its consolidated financial statements as the current projected minimum lease payments under existing lease contracts subject to the new pronouncement are less than one percent of its current assets.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments–Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU will have a significant impact on the Company's calculation and accounting for its Allowance for Loan Losses as well as credit losses related to investment securities available-for-sale. A summary of significant provisions of this ASU is as follows:

- The ASU requires that a financial asset (or a group of financial assets) measured at amortized cost basis be presented, net of a valuation allowance for credit losses, at an amount expected to be collected on the financial asset(s), and that the income statement include the measurement of credit losses for newly recognized financial assets as well as changes in expected losses on previously recognized financial assets. The provisions of this ASU require measurement of expected credit losses based on relevant information including past events, historical experience, current conditions, and reasonable and supportive forecasts that affect the collectability of the asset. The provisions of this ASU differ from current U.S. GAAP in that current U.S. GAAP generally delays recognition of the full amount of credit losses until the loss is probable of occurring.
- The amendments in the Update retain many of the disclosure requirements related to credit quality in current U.S. GAAP, updated to reflect the change from an incurred loss methodology to an expected credit loss methodology. In addition, the Update requires that disclosure of credit quality indicators in relation to the amortized cost of financing receivables, a current requirement, be further disaggregated by year of origination.
- This ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down, and limits the amount of the allowance for credit losses to the amount by which the fair value is below amortized cost. For purchased investment securities available-for-sale with a more-than-insignificant amount of credit deterioration since origination, the ASU requires an allowance be determined in a manner similar to other investment securities available-for-sale; however, the initial allowance would be added to the purchase price, with only subsequent changes in the allowance recorded in credit loss expense, and interest income recognized at the effective rate excluding the discount embedded in the purchase price related to estimated credit losses at acquisition.
- This ASU will be effective for the Company for interim and annual periods beginning in the first quarter of 2020. Earlier adoption is permitted beginning in the first quarter of 2019. The Company will record the effect of implementing this ASU through a cumulative-effect adjustment through retained earnings as of the beginning of the reporting period in which Topic 326 is effective.

The Company cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our financial condition or results of operations. Further, any impact on the allowance upon adoption is currently unknown but any change in allowance levels will affect regulatory capital and ratios.

In June 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230) –Classification of Certain Cash Receipts and Cash Payments. This Update provides clarification regarding eight specific cash flow issues with the objective of reducing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. For the Company, the amendments in this Update are effective beginning in the first quarter 2018. The amendments in this Update should be applied using a retroactive transition method to each period presented. The Company anticipates there will be no adjustments to the Consolidated Statements of Cash Flows, as previously reported, as a result of the clarifications provided in the Update.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350) to simplify the accounting for goodwill impairment. This guidance, among other things, removes step 2 of the goodwill impairment test

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

thus eliminating the need to determine the fair value of individual assets and liabilities of the reporting unit. Upon adoption of this ASU, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This may result in more or less impairment being recognized than under current guidance. This Update will become effective for the Company's annual and interim goodwill impairment tests beginning in the first quarter of 2020.

In August 2017, the Financial Accounting Standards Board issued ASU 2017-12, "Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities". The purpose of this updated guidance is to better align a company's financial reporting for hedging activities with the economic objectives of those activities. ASU 2017-12 is effective for public business entities for fiscal years beginning after December 15, 2018, with early adoption, including adoption in an interim period, permitted. The Company plans to adopt ASU 2017-12 on January 1, 2019. ASU 2017-12 requires a modified retrospective transition method in which the Company will recognize the cumulative effect of the change on the opening balance of each affected component of equity in the statement of financial position as of the date of adoption. While the Company continues to assess all potential impacts of the standard, we currently expect adoption to have an immaterial impact on our consolidated financial statements, as exposure to derivatives contracts is only offered under special circumstances. The Company will continue to assess the financial statement impact as adoption draws closer and/or exposure to derivatives contracts grows to a level deemed to be material.

2. Other comprehensive loss:

The components of other comprehensive loss and their related tax effects are reported in the Consolidated Statements of Income and Comprehensive Income. The accumulated other comprehensive loss included in the Consolidated Balance Sheets relates to net unrealized gains and losses on investment securities available-for-sale and benefit plan adjustments.

The components of accumulated other comprehensive loss included in stockholders' equity at September 30, 2017 and December 31, 2016 is as follows:

	September 30, 2017	December 31, 2016
Net unrealized gain on investment securities available-for-sale	\$ 1,629	\$ 553
Income tax	570	193
Net of income taxes	1,059	360
Benefit plan adjustments	(6,946)	(6,946)
Income tax	(2,431)	(2,431)
Net of income taxes	(4,515)	(4,515)
Accumulated other comprehensive loss	<u>\$ (3,456)</u>	<u>\$ (4,155)</u>

Other comprehensive income (loss) and related tax effects for the three and nine months ended September 30, 2017 and 2016 is as follows:

Three Months Ended September 30,	2017	2016
Unrealized loss on investment securities available-for-sale	\$ (381)	\$ (1,120)
Net gain on the sale of investment securities available-for-sale(1)		
Other comprehensive loss before taxes	(381)	(1,120)
Income tax benefit	(133)	(392)
Other comprehensive loss before taxes	<u>\$ (248)</u>	<u>\$ (728)</u>

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

Nine Months Ended September 30,	2017	2016
Unrealized gain on investment securities available-for-sale	\$ 1,076	\$ 1,003
Net gain on the sale of investment securities available-for-sale(1)		(623)
Other comprehensive income gain before taxes	1,076	380
Income tax expense	377	133
Other comprehensive income	<u>\$ 699</u>	<u>\$ 247</u>

(1) Represents amounts reclassified out of accumulated other comprehensive loss and included in gains on sale of investment securities on the consolidated statements of income and comprehensive income.

3. Earnings per share:

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance.

There were no shares considered anti-dilutive for the three and nine month periods ended September 30, 2017 and 2016.

	2017		2016	
For the Three Months Ended September 30,	Basic	Diluted	Basic	Diluted
Net Income	\$ 5,350	\$ 5,350	\$ 5,118	\$ 5,118
Average common shares outstanding	7,396,505	7,396,505	7,394,143	7,394,143
Earnings per share	\$ 0.72	\$ 0.72	\$ 0.69	\$ 0.69

	2017		2016	
For the Nine Months Ended September 30	Basic	Diluted	Basic	Diluted
Net Income	\$ 15,809	\$ 15,809	\$ 14,855	\$ 14,855
Average common shares outstanding	7,395,612	7,395,612	7,397,581	7,397,581
Earnings per share	\$ 2.14	\$ 2.14	\$ 2.01	\$ 2.01

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4. Investment securities:

The amortized cost and fair value of investment securities aggregated by investment category at September 30, 2017 and December 31, 2016 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2017				
Available-for-sale:				
U.S. Treasury securities	\$ 20,045	\$ 29	\$ 28	\$ 20,046
U.S. Government-sponsored enterprises	85,482	83	915	84,650
State and municipals:				
Taxable	14,594	615	2	15,207
Tax-exempt	98,494	2,062	51	100,505
Residential Mortgage-backed securities:				
U.S. Government agencies	16,045	21	33	16,033
U.S. Government-sponsored enterprises	16,492	29	95	16,426
Commercial Mortgage-backed securities:				
U.S. Government-sponsored enterprises	6,326		85	6,241
Common equity securities	30			30
Total	<u>\$ 257,508</u>	<u>\$ 2,839</u>	<u>\$ 1,209</u>	<u>\$ 259,138</u>
Held-to-maturity:				
Tax-exempt state and municipals	\$ 6,859	\$ 185	\$ 2	\$ 7,042
Residential Mortgage-backed securities:				
U.S. Government agencies	58			58
U.S. Government-sponsored enterprises	2,647	165		2,812
Total	<u>\$ 9,564</u>	<u>\$ 350</u>	<u>\$ 2</u>	<u>\$ 9,912</u>
December 31, 2016				
Available-for-sale:				
U.S. Treasury securities	\$ 7,570		\$ 132	\$ 7,438
U.S. Government-sponsored enterprises	82,314	\$ 79	1,480	80,913
State and municipals:				
Taxable	14,698	566	39	15,225
Tax-exempt	110,931	2,309	640	112,600
Residential Mortgage-backed securities:				
U.S. Government agencies	21,041	48	47	21,042
U.S. Government-sponsored enterprises	22,303	48	159	22,192
Total	<u>\$ 258,857</u>	<u>\$ 3,050</u>	<u>\$ 2,497</u>	<u>\$ 259,410</u>
Held-to-maturity:				
Tax-exempt state and municipals	\$ 6,862	\$ 72	\$ 67	\$ 6,867
Residential Mortgage-backed securities:				
U.S. Government agencies	68	1		69
U.S. Government-sponsored enterprises	3,587	191		3,778
Total	<u>\$ 10,517</u>	<u>\$ 264</u>	<u>\$ 67</u>	<u>\$ 10,714</u>

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

The maturity distribution of the fair value, which is the net carrying amount, of the debt securities classified as available-for-sale at September 30, 2017, is summarized as follows:

September 30, 2017	Fair Value
Within one year	\$ 15,858
After one but within five years	148,810
After five but within ten years	40,582
After ten years	15,158
	<u>220,408</u>
Mortgage-backed securities	38,700
Total	<u>\$ 259,108</u>

The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at September 30, 2017, is summarized as follows:

September 30, 2017	Amortized Cost	Fair Value
Within one year		
After one but within five years		
After five but within ten years		
After ten years	\$ 6,859	\$ 7,042
	<u>6,859</u>	<u>7,042</u>
Mortgage-backed securities	2,705	2,870
Total	<u>\$ 9,564</u>	<u>\$ 9,912</u>

Securities with a carrying value of \$165,205 and \$144,750 at September 30, 2017 and December 31, 2016, respectively, were pledged to secure public deposits and certain other deposits as required or permitted by law.

Securities and short-term investment activities are conducted with a diverse group of government entities, corporations and state and local municipalities. The counterparty's creditworthiness and type of collateral is evaluated on a case-by-case basis. At September 30, 2017 and December 31, 2016, there were no significant concentrations of credit risk from any one issuer, with the exception of U.S. Government agencies and sponsored enterprises that exceeded 10.0 percent of stockholders' equity.

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The fair value and gross unrealized losses of investment securities with unrealized losses for which an other-than-temporary impairment ("OTTI") has not been recognized at September 30, 2017 and December 31, 2016, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, are summarized as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2017						
U.S. Treasury securities	\$ 5,494	\$ 28			\$ 5,494	\$ 28
U.S. Government-sponsored enterprises	48,573	376	\$ 29,309	\$ 539	77,882	915
State and municipals:						
Taxable	551	2			551	2
Tax-exempt	5,330	50	2,482	3	7,812	53
Residential Mortgage-backed securities:						
U.S. Government agencies	5,671	13	3,175	20	8,846	33
U.S. Government-sponsored enterprises	8,492	25	4,775	70	13,267	95
Commercial Mortgage-backed securities:						
U.S. Government-sponsored enterprises	6,241	85			6,241	85
Total	\$ 80,352	\$ 579	\$ 39,741	\$ 632	\$ 120,093	\$ 1,211
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016						
U.S. Treasury securities	\$ 7,438	\$ 132			\$ 7,438	\$ 132
U.S. Government-sponsored enterprises	59,460	1,480			59,460	1,480
State and municipals:						
Taxable	1,035	39			1,035	39
Tax-exempt	55,166	707	\$ 226		55,392	707
Residential Mortgage-backed securities:						
U.S. Government agencies	5,917	27	1,496	\$ 20	7,413	47
U.S. Government-sponsored enterprises	16,412	85	2,712	74	19,124	159
Total	\$ 145,428	\$ 2,470	\$ 4,434	\$ 94	\$ 149,862	\$ 2,564

The Company had 74 investment securities, consisting of 11 tax-exempt state and municipal obligations, 2 U.S. Treasury securities, one taxable municipal obligation, 29 U.S. Government-sponsored enterprise securities, and 31 mortgage-backed securities that were in unrealized loss positions at September 30, 2017. Of these securities, 4 tax-exempt state and municipal obligations, 14 mortgage-backed securities and 10 U.S. Government-sponsored enterprise securities were in a continuous unrealized loss position for twelve months or more. Management does not consider the unrealized losses on the debt securities, as a result of changes in interest rates, to be OTTI based on historical evidence that indicates the cost of these securities is recoverable within a reasonable period of time in relation to normal cyclical changes in the market rates of interest. Moreover, because there has been no material change in the credit quality of the issuers or other events or circumstances that may cause a significant adverse impact on the fair value of these securities, and management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be maturity, the Company does not consider the unrealized losses to be OTTI at September 30, 2017. There was no OTTI recognized for the three or nine months ended September 30, 2017 and 2016.

The Company had 163 investment securities, consisting of 107 tax-exempt state and municipal obligations, 2 taxable state and municipal obligations, 2 U.S. Treasury securities, 22 U.S. Government-sponsored enterprise securities and 30 mortgage-backed securities that were in unrealized loss positions at December 31, 2016. Of these securities, 9 mortgage-backed securities, and 2 tax-exempt state and municipal securities were in a continuous unrealized loss position for twelve months or more.

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5. Loans, net and allowance for loan losses:

The major classifications of loans outstanding, net of deferred loan origination fees and costs at September 30, 2017 and December 31, 2016 are summarized as follows. Net deferred loan costs were \$646 and \$579 at September 30, 2017 and December 31, 2016.

	<u>September 30, 2017</u>	<u>December 31, 2016</u>
Commercial	\$ 449,464	\$ 408,814
Real estate:		
Commercial	751,510	700,144
Residential	289,582	289,781
Consumer	141,959	134,226
Total	<u>\$ 1,632,515</u>	<u>\$ 1,532,965</u>

The changes in the allowance for loan losses account by major classification of loan for the three and nine months ended September 30, 2017 and 2016 are summarized as follows:

<u>September 30, 2017</u>	<u>Commercial</u>	<u>Real estate</u>		<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
		<u>Commercial</u>	<u>Residential</u>			
Allowance for loan losses:						
Beginning Balance July 1, 2017	\$ 4,426	\$ 6,587	\$ 5,196	\$ 1,593	\$	\$ 17,802
Charge-offs	(17)		(82)	(169)		(268)
Recoveries	3	41	4	49		97
Provisions	358	566	175	101		1,200
Ending balance	<u>\$ 4,770</u>	<u>\$ 7,194</u>	<u>\$ 5,293</u>	<u>\$ 1,574</u>	<u>\$</u>	<u>\$ 18,831</u>
<u>September 30, 2016</u>	<u>Commercial</u>	<u>Real estate</u>		<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
		<u>Commercial</u>	<u>Residential</u>			
Allowance for loan losses:						
Beginning Balance July 1, 2016	\$ 3,263	\$ 5,077	\$ 4,465	\$ 1,679	\$ 315	\$ 14,799
Charge-offs		(72)	(153)	(130)		(355)
Recoveries	2	28	4	34		68
Provisions	321	548	245	86		1,200
Ending balance	<u>\$ 3,586</u>	<u>\$ 5,581</u>	<u>\$ 4,561</u>	<u>\$ 1,669</u>	<u>\$ 315</u>	<u>\$ 15,712</u>

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		Real estate		Consumer	Unallocated	Total
September 30, 2017	Commercial	Commercial	Residential			
Allowance for loan losses:						
Beginning Balance January 1, 2017	\$ 3,799	\$ 5,847	\$ 4,707	1,608		15,961
Charge-offs	(49)	(367)	(105)	(489)		(1,010)
Recoveries	16	96	30	138		280
Provisions	1,004	1,618	661	317		3,600
Ending balance	\$ 4,770	\$ 7,194	\$ 5,293	\$ 1,574	\$	\$ 18,831

		Real estate		Consumer	Unallocated	Total
September 30, 2016	Commercial	Commercial	Residential			
Allowance for loan losses:						
Beginning Balance January 1, 2016	\$ 3,042	\$ 4,245	\$ 4,082	\$ 1,583	\$ 23	\$ 12,975
Charge-offs	(396)	(175)	(279)	(260)		(1,110)
Recoveries	38	58	39	112		247
Provisions	902	1,453	719	234	292	3,600
Ending balance	\$ 3,586	\$ 5,581	\$ 4,561	\$ 1,669	\$ 315	\$ 15,712

The allocation of the allowance for loan losses and the related loans by major classifications of loans at September 30, 2017 and December 31, 2016 is summarized as follows:

		Real estate		Consumer	Unallocated	Total
September 30, 2017	Commercial	Commercial	Residential			
Allowance for loan losses:						
Ending balance	\$ 4,770	\$ 7,194	\$ 5,293	\$ 1,574	\$	\$ 18,831
Ending balance:						
individually evaluated for impairment	436	631	616	23		1,706
Ending balance:						
collectively evaluated for impairment	4,334	6,563	4,677	1,551		17,125
Ending balance: loans acquired with deteriorated credit quality	\$	\$	\$	\$	\$	\$
Loans receivable:						
Ending balance	\$ 449,464	\$ 751,510	\$ 289,582	\$ 141,959	\$	\$ 1,632,515
Ending balance:						
individually evaluated for impairment	2,789	4,062	3,697	194		10,742
Ending balance:						
collectively evaluated for impairment	446,322	746,802	285,854	141,765		1,620,743
Ending balance: loans acquired with deteriorated credit quality	\$ 353	\$ 646	\$ 31	\$	\$	\$ 1,030

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December 31, 2016	Commercial	Real estate		Consumer	Unallocated	Total
		Commercial	Residential			
Allowance for loan losses:						
Ending balance	\$ 3,799	\$ 5,847	\$ 4,707	\$ 1,608	\$	\$ 15,961
Ending balance: individually evaluated for impairment	225	1,197	520			1,942
Ending balance: collectively evaluated for impairment	3,574	4,650	4,187	1,608		14,019
Ending balance: loans acquired with deteriorated credit quality	\$	\$	\$	\$	\$	\$
Loans receivable:						
Ending balance	\$ 408,814	\$ 700,144	\$ 289,781	\$ 134,226	\$	\$ 1,532,965
Ending balance: individually evaluated for impairment	1,724	5,820	3,543	155		11,242
Ending balance: collectively evaluated for impairment	406,127	692,987	286,201	134,071		1,519,386
Ending balance: loans acquired with deteriorated credit quality	\$ 963	\$ 1,337	\$ 37	\$	\$	\$ 2,337

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

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

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The following tables present the major classification of loans summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system at September 30, 2017 and December 31, 2016:

September 30, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 441,503	\$ 5,028	\$ 2,933	\$	\$ 449,464
Real estate:					
Commercial	724,659	14,730	12,121		751,510
Residential	283,690	19	5,873		289,582
Consumer	141,618		341		141,959
Total	<u>\$ 1,591,470</u>	<u>\$ 19,777</u>	<u>\$ 21,268</u>	<u>\$</u>	<u>\$ 1,632,515</u>

December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 398,867	\$ 6,222	\$ 3,725	\$	\$ 408,814
Real estate:					
Commercial	674,914	10,392	14,838		700,144
Residential	282,737	233	6,811		289,781
Consumer	133,983		243		134,226
Total	<u>\$ 1,490,501</u>	<u>\$ 16,847</u>	<u>\$ 25,617</u>	<u>\$</u>	<u>\$ 1,532,965</u>

Information concerning nonaccrual loans by major loan classification at September 30, 2017 and December 31, 2016 is summarized as follows:

	September 30, 2017	December 31, 2016
Commercial	\$ 1,263	\$ 934
Real estate:		
Commercial	4,233	7,016
Residential	3,031	3,003
Consumer	194	155
Total	<u>\$ 8,721</u>	<u>\$ 11,108</u>

The major classifications of loans by past due status are summarized as follows:

September 30, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
Commercial	\$ 260	\$ 84	\$ 1,263	\$ 1,607	\$ 447,857	\$ 449,464	
Real estate:							
Commercial	831	135	4,233	5,199	746,311	751,510	
Residential	1,756	147	4,312	6,215	283,367	289,582	\$ 1,281
Consumer	846	357	423	1,626	140,333	141,959	229
Total	<u>\$ 3,693</u>	<u>\$ 723</u>	<u>\$ 10,231</u>	<u>\$ 14,647</u>	<u>\$ 1,617,868</u>	<u>\$ 1,632,515</u>	<u>\$ 1,510</u>

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			Greater				Loans > 90
December 31, 2016	30-59 Days Past Due	60- 89 Days Past Due	than 90 Days	Total Past Due	Current	Total Loans	Days and Accruing
Commercial	\$ 249	\$ 75	\$ 934	\$ 1,258	\$ 407,556	\$ 408,814	
Real estate:							
Commercial	4,782	527	7,016	12,325	687,819	700,144	
Residential	2,100	354	3,561	6,015	283,766	289,781	\$ 558
Consumer	962	259	441	1,662	132,564	134,226	286
Total	<u>\$ 8,093</u>	<u>\$ 1,215</u>	<u>\$ 11,952</u>	<u>\$ 21,260</u>	<u>\$ 1,511,705</u>	<u>\$ 1,532,965</u>	<u>\$ 844</u>

The following tables summarize information concerning impaired loans as of and for the three and nine months ended September 30, 2017 and September 30, 2016, and as of and for the year ended, December 31, 2016 by major loan classification:

				This Quarter		Year-to-Date	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
September 30, 2017							
With no related allowance:							
Commercial	\$ 2,310	\$ 2,455		\$ 1,945	\$ 28	\$ 1,765	\$ 63
Real estate:							
Commercial	2,900	3,192		2,979	6	3,009	19
Residential	2,303	2,727		2,193	4	2,235	10
Consumer	171	183		180		175	
Total	<u>7,684</u>	<u>8,557</u>		<u>7,297</u>	<u>38</u>	<u>7,184</u>	<u>92</u>
With an allowance recorded:							
Commercial	833	910	\$ 436	783		943	
Real estate:							
Commercial	1,807	2,073	631	1,673	6	2,402	13
Residential	1,425	1,663	616	1,330	8	1,270	22
Consumer	23	23	23	34		23	
Total	<u>4,088</u>	<u>4,669</u>	<u>1,706</u>	<u>3,820</u>	<u>14</u>	<u>4,638</u>	<u>35</u>
Commercial	3,143	3,365	436	2,728	28	2,708	63
Real estate:							
Commercial	4,707	5,265	631	4,652	12	5,411	32
Residential	3,728	4,390	616	3,523	12	3,505	32
Consumer	194	206	23	214		198	
Total	<u>\$ 11,772</u>	<u>\$ 13,226</u>	<u>\$ 1,706</u>	<u>\$ 11,117</u>	<u>\$ 52</u>	<u>\$ 11,822</u>	<u>\$ 127</u>

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					For the Year Ended	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	
December 31, 2016						
With no related allowance:						
Commercial	\$ 2,404	\$ 3,213		\$ 1,461	\$ 48	
Real estate:						
Commercial	2,364	3,018		4,300	71	
Residential	2,205	2,388		2,133	35	
Consumer	155	155		147		
Total	7,128	8,774		8,041	154	
With an allowance recorded:						
Commercial	283	283	\$ 225	859		
Real estate:						
Commercial	4,793	4,793	1,197	2,366	2	
Residential	1,375	1,376	520	1,185	7	
Consumer				50		
Total	6,451	6,452	1,942	4,460	9	
Commercial	2,687	3,496	225	2,320	48	
Real estate:						
Commercial	7,157	7,811	1,197	6,666	73	
Residential	3,580	3,764	520	3,318	42	
Consumer	155	155		197		
Total	\$ 13,579	\$ 15,226	\$ 1,942	\$ 12,501	\$ 163	

				This Quarter		Year-to-Date	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
September 30, 2016							
With no related allowance:							
Commercial	\$ 970	\$ 1,876		\$ 1,133	\$ 10	\$ 1,214	40
Real estate:							
Commercial	6,156	6,812		5,837	9	4,396	70
Residential	2,171	2,354		2,056	3	2,263	14
Consumer	188	188		173		119	
Total	9,485	11,230		9,199	22	7,992	124
With an allowance recorded:							
Commercial	1,396	1,396	\$ 895	1,006		954	\$
Real estate:							
Commercial	743	743	337	821		1,877	
Residential	1,093	1,093	638	1,186		1,263	4
Consumer	41	41	41	56		80	
Total	3,273	3,273	1,911	3,069	—	4,174	4
Commercial	2,366	3,272	895	2,139	10	2,168	40
Real estate:							
Commercial	6,899	7,555	337	6,658	9	6,273	70
Residential	3,264	3,447	638	3,242	3	3,526	18
Consumer	229	229	41	229		199	
Total	\$ 12,758	\$ 14,503	\$ 1,911	\$ 12,268	\$ 22	\$ 12,166	\$ 128

Included in the commercial real estate, residential real estate and commercial loan categories are troubled debt restructurings that are classified as impaired. Troubled debt restructurings totaled \$3,365 at September 30, 2017, \$1,909 at December 31, 2016 and \$2,666 at September 30, 2016.

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

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

There were four loans, representing two credit relationships, modified as troubled debt restructurings for the three months ended September 30, 2017 totaling \$1,249. For the nine months ended September 30, 2017, six loans were modified as troubled debt restructurings in the amount of \$1,658. There were no loans modified as troubled debt restructurings for the three months ended September 30, 2016. For the nine months ended September 30, 2016, there was one loan modified as a troubled debt restructuring in the amount of \$75. During the three and nine months ended September 30, 2017, there were no payment defaults on loans restructured within the last twelve months. During the three months ended September 30, 2016, there were no payment defaults on loans restructured within the last twelve months. During the nine months ended September 30, 2016, there were two payment defaults on restructured residential real estate loans totaling \$208.

6. Other assets and gain on sale of merchant services business:

The components of other assets at September 30, 2017, and December 31, 2016 are summarized as follows:

	September 30, 2017	December 31, 2016
Other real estate owned	\$ 358	\$ 393
Investment in residential housing program	7,959	8,312
Mortgage servicing rights	728	698
Bank owned life insurance	33,646	33,073
Restricted equity securities	6,341	7,051
Other assets	17,374	15,974
Total	\$ 66,406	\$ 65,501

In the second quarter of 2017, the Company entered into and executed a merchant asset sales agreement with a third party to sell and transfer the Company's merchant business. Proceeds from the sale were received on June 30, 2017 in the amount of \$2,300. In connection with the sale, merchant related equipment in the amount of \$22 previously included in other assets above were sold, resulting in a net gain of \$2,278 to the Company which is included in noninterest income in the accompanying consolidated statements of income for the nine months ended September 30, 2017. The sale represents the entirety of the Company's merchant services business and the Company will no longer originate any proprietary merchant service relationships. The Company did not receive an ownership interest in the unrelated purchaser of the merchant business. The \$2,300 represents the entire consideration received by the Company under the merchant asset sales agreement and there is no form of contingent consideration. Separate from the merchant asset sales

Peoples Financial Services Corp.
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agreement, the Company entered into a marketing and sales agreement with the merchant business purchaser to share in future revenue generated from the sold merchant portfolio, and from new merchant referrals.

7. Fair value estimates:

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

In accordance with FASB ASC 820, "Fair Value Measurements and Disclosures," fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets. In many cases, these values cannot be realized in immediate settlement of the instrument.

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

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

- Level 1: Unadjusted quoted prices of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

An asset's or liability's placement in the fair value hierarchy is based on the lowest level of input that is significant to the fair value estimate.

The following methods and assumptions were used by the Company to calculate fair values and related carrying amounts of financial instruments:

Cash and cash equivalents: The carrying values of cash and cash equivalents as reported on the balance sheet approximate fair value.

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

Peoples Financial Services Corp.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
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Loans held for sale: The fair values of loans held for sale are based upon current delivery prices in the secondary mortgage market.

Net loans: For adjustable-rate loans that re-price frequently and with no significant credit risk, fair values are based on carrying values. The fair values of other non-impaired loans are estimated using discounted cash flow analysis, using interest rates currently offered in the market for loans with similar terms to borrowers of similar credit risk. Fair values for impaired loans are estimated using discounted cash flow analysis determined by the loan review function or underlying collateral values, where applicable.

Mortgage servicing rights: To determine the fair value, the Company estimates the present value of future cash flows incorporating assumptions such as cost of servicing, discount rates, prepayment speeds and default rates.

Accrued interest receivable: The carrying value of accrued interest receivable as reported on the balance sheet approximates fair value.

Restricted equity securities: The carrying values of restricted equity securities approximate fair value, due to the lack of marketability for these securities.

Deposits: The fair values of noninterest-bearing deposits and savings, NOW and money market accounts are the amounts payable on demand at the reporting date. The fair value estimates do not include the benefit that results from such low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. The carrying values of adjustable-rate, fixed-term time deposits approximate their fair values at the reporting date. For fixed-rate time deposits, the present value of future cash flows is used to estimate fair values. The discount rates used are the current rates offered for time deposits with similar maturities.

Short-term borrowings: The carrying values of short-term borrowings approximate fair value.

Long-term debt: The fair value of fixed-rate long-term debt is based on the present value of future cash flows. The discount rate used is the current rate offered for long-term debt with the same maturity.

Accrued interest payable: The carrying value of accrued interest payable as reported on the balance sheet approximates fair value.

Interest rate swaps: The Company's interest rate swaps are reported at fair value utilizing Level 2 inputs. Values of these instruments are obtained through an independent pricing source utilizing information which may include market observed quotations for swaps, Libor rates, forward rates and rate volatility. Derivative contracts create exposure to interest rate movements as well as risks from the potential of non-performance of the counterparty.

Off-balance sheet financial instruments:

The majority of commitments to extend credit, unused portions of lines of credit and standby letters of credit carry current market interest rates if converted to loans. Because such commitments are generally unassignable to either the Company or the borrower, they only have value to the Company and the borrower. None of the commitments are subject to undue credit risk. The estimated fair values of off-balance sheet financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of off-balance sheet financial instruments was not material at September 30, 2017 and December 31, 2016.

Peoples Financial Services Corp.
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Assets and liabilities measured at fair value on a recurring basis at September 30, 2017 and December 31, 2016 are summarized as follows:

		Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2017	Amount			
U.S. Treasury securities	\$ 20,046	\$ 20,046		\$
U.S. Government-sponsored enterprises	84,650		\$ 84,650	
State and Municipals:				
Taxable	15,207		15,207	
Tax-exempt	100,505		100,505	
Mortgage-backed securities:				
U.S. Government agencies	16,033		16,033	
U.S. Government-sponsored enterprises	22,667		22,667	
Common equity securities	30	30		
Interest Rate Swap-other assets	548		548	
Interest Rate Swap-other liabilities	(603)		(603)	
Total	\$ 259,083	\$ 20,076	\$ 239,007	\$
		Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016	Amount			
U.S. Treasury securities	\$ 7,438	\$ 7,438		\$
U.S. Government-sponsored enterprises	80,913		\$ 80,913	
State and Municipals:				
Taxable	15,225		15,225	
Tax-exempt	112,600		112,600	
Mortgage-backed securities:				
U.S. Government agencies	21,042		21,042	
U.S. Government-sponsored enterprises	22,192		22,192	
Total	\$ 259,410	\$ 7,438	\$ 251,972	\$

Assets and liabilities measured at fair value on a nonrecurring basis at September 30, 2017 and December 31, 2016 are summarized as follows:

		Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2017	Amount			
Impaired loans	\$ 1,613			\$ 1,613
Other real estate owned	\$ 358			\$ 358
		Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016	Amount			
Impaired loans	\$ 3,193			\$ 3,193
Other real estate owned	\$ 371			\$ 371

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Fair values of impaired loans are based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

Quantitative Information about Level 3 Fair Value Measurements				
September 30, 2017	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Impaired loans	\$ 1,613	Appraisal of collateral	Appraisal adjustments	5.9% to 98.2% (77.3)%
			Liquidation expenses	3.0% to 6.0% (4.8)%
Other real estate owned	\$ 358	Appraisal of collateral	Appraisal adjustments	25.0% to 38.2% (26.9)%
			Liquidation expenses	3.0% to 6.0% (5.0)%

Quantitative Information about Level 3 Fair Value Measurements				
December 31, 2016	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Impaired loans	\$ 3,193	Appraisal of collateral	Appraisal adjustments	18.0% to 97.0% (74.5)%
			Liquidation expenses	3.0% to 6.0% (5.3)%
Other real estate owned	\$ 371	Appraisal of collateral	Appraisal adjustments	25.0% to 54.6% (43.1)%
			Liquidation expenses	3.0% to 6.0% (5.0)%

Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 Inputs which are not identifiable.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

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The carrying and fair values of the Company's financial instruments at September 30, 2017 and December 31, 2016 and their placement within the fair value hierarchy are as follows:

	Carrying Value	Fair Value	Fair Value Hierarchy		
			Quoted Prices in Active Markets for Identical Assets (level 1)	Significant Other Observable Inputs (level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2017					
Financial assets:					
Cash and cash equivalents	\$ 32,906	\$ 32,906	\$ 32,906		
Investment securities:					
Available-for-sale	259,686	259,686	20,076	\$ 239,610	
Held-to-maturity	9,564	9,912		9,912	
Loans held for sale	460	460		460	
Net loans	1,613,684	1,595,623			\$ 1,595,623
Accrued interest receivable	5,908	5,908		5,908	
Mortgage servicing rights	728	1,655		1,655	
Restricted equity securities	6,341	6,341		6,341	
Interest rate swap	548	548		548	
Total	<u>\$ 1,929,825</u>	<u>\$ 1,912,579</u>			
Financial liabilities:					
Deposits	\$ 1,687,855	\$ 1,686,678		\$ 1,686,678	
Short-term borrowings	71,900	71,900		71,900	
Long-term debt	50,199	50,984		50,984	
Accrued interest payable	481	481		481	
Interest rate swap	603	603		603	
Total	<u>\$ 1,811,038</u>	<u>\$ 1,810,646</u>			

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	Carrying Value	Fair Value	Fair Value Hierarchy		
			Quoted Prices in Active Markets for Identical Assets (level 1)	Significant Other Observable Inputs (level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016					
Financial assets:					
Cash and cash equivalents	\$ 39,941	\$ 39,941	\$ 39,941		
Investment securities:					
Available-for-sale	259,410	259,410	\$ 7,438	\$ 251,972	
Held-to-maturity	10,517	10,714		10,714	
Loans held for sale					
Net loans	1,517,004	1,507,936			\$ 1,507,936
Accrued interest receivable	6,228	6,228		6,228	
Mortgage servicing rights	698	1,587		1,587	
Restricted equity securities	7,051	7,051		7,051	
Total	<u>\$ 1,840,849</u>	<u>\$ 1,832,867</u>			
Financial liabilities:					
Deposits	\$ 1,588,757	\$ 1,587,701		\$ 1,587,701	
Short-term borrowings	82,700	82,700		82,700	
Long-term debt	58,134	58,987		58,987	
Accrued interest payable	462	462		462	
Total	<u>\$ 1,730,053</u>	<u>\$ 1,729,850</u>			

8. Employee benefit plans:

The Company provides an Employee Stock Ownership Plan ("ESOP") and a Retirement Profit Sharing Plan. The Company also maintains a Supplemental Executive Retirement Plan ("SERP") and an Employees' Pension Plan, which is currently frozen.

For the three and nine months ended September 30, salaries and employee benefits expense includes approximately \$311 and \$982 in 2017 and \$240 and \$843 in 2016 relating to the employee benefit plans.

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Components of net periodic benefit cost are as follows:

Three Months Ended September 30,	Pension Benefits	
	2017	2016
Components of net periodic pension cost:		
Interest cost	\$ 217	\$ 166
Expected return on plan assets	(305)	(223)
Amortization of unrecognized net gain	65	52
Net periodic other benefit cost	\$ (23)	\$ (5)

Nine Months Ended September 30,	Pension Benefits	
	2017	2016
Components of net periodic pension cost:		
Interest cost	\$ 433	\$ 499
Expected return on plan assets	(610)	(670)
Amortization of unrecognized net gain	130	156
Net periodic other benefit cost	\$ (47)	\$ (15)

The 2008 long-term incentive plan ("2008 Plan") allows for eligible participants to be granted equity awards. The plan was a legacy plan of Pensco Financial Services Corporation. Under the 2008 Plan the Compensation Committee of the board of directors has broad authority with respect to awards granted under the 2008 Plan, including, without limitation, the authority to:

- Designate the individuals eligible to receive awards under the 2008 Plan.
- Determine the size, type and date of grant for individual awards, provided that awards approved by the Committee are not effective unless and until ratified by the board of directors.
- Interpret the 2008 Plan and award agreements issued with respect to individual participants.

In May 2017, the Company's stockholders approved the 2017 equity incentive plan ("2017 Plan"). The 2017 Plan allows for eligible participants to be granted equity awards. Under the 2017 Plan the Compensation Committee of the board of directors has the authority to, among other things:

- Select the persons to be granted awards under the 2017 Plan.
- Determine the type, size and term of awards.
- Determine whether such performance objectives and conditions have been met.
- Accelerate the vesting or exercisability of an award.

Persons eligible to receive awards under the 2008 and 2017 Plans include directors, officers, employees, consultants and other service providers of the Company and its subsidiaries, except that incentive stock option may be granted only to individuals who are employees on the date of grant.

As of September 30, 2017, there were 120,116 shares of the Company's common stock available for grant as awards pursuant to the 2008 Plan and there were 98,462 shares of the Company's common stock available for grant as awards pursuant to the 2017 Plan. The 2008 Plan will expire in January 2018. While the 2008 Plan will remain in effect in accordance with its terms to govern outstanding awards under that plan, the Company intends to make future grants under the 2017 Plan. If any outstanding awards are forfeited by the holder or canceled by the Company, the underlying shares would be available for regrant to others.

Peoples Financial Services Corp.

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The 2008 Plan authorizes grants of stock options, stock appreciation rights, dividend equivalents, performance awards, restricted stock and restricted stock units. The 2017 Plan authorizes grants of stock options, stock appreciation rights, cash awards, performance awards, restricted stock and restricted stock units.

In 2017, the Company awarded 2,020 shares of non-performance-based restricted stock, bringing the total of nonvested restricted stock awards to 14,382 shares, and 7,071 performance-based restricted stock units under the 2008 Plan. Also in 2017, the Company awarded 342 shares of non-performance based restricted stock and 1,196 performance based restricted stock units under the 2017 Plan. In 2016, the Company did not make any awards under the 2008 Plan.

The non-performance restricted stock grants made in 2017 vest equally over three years from the grant date. Grants of restricted stock made in prior periods cliff vest after five years. The performance-based restricted stock units vest three years after the grant date and include conditions based on the Company's three year cumulative diluted earnings per share and three-year average return on equity that determines the number of restricted stock units that may vest.

The Company expenses the fair value of all-share based compensation over the requisite service period commencing at grant date. The fair value of restricted stock is expensed on a straight-line basis. The Company periodically assesses the probability of achievement of the performance criteria and adjusts the amount of compensation expense accordingly. Compensation is recognized over the vesting period and adjusted for the probability of achievement of the performance criteria. The Company classifies share-based compensation for employees within "salaries and employee benefits expense" on the Consolidated Statements of Income and Comprehensive Income.

The Company recognized compensation expense of \$41 and \$89 for the three and nine months ended September 30, 2017 and did not recognize any compensation expense for the three and nine months ended September 30, 2016 for awards granted under the 2008 Plan. As of September 30, 2017, the Company had \$338 of unrecognized compensation expense associated with awards. The remaining cost is expected to be recognized over a weighted average vesting period of 2.5 years.

9. Derivatives and hedging activities

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities. The Company's existing interest rate derivatives result from a service provided to certain qualifying customers and, therefore, are not used to manage interest rate risk in the Company's assets or liabilities. The Company manages a matched book with respect to its derivative instruments in order to minimize its net risk exposure resulting from such transactions.

Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Balance Sheet as of September 30, 2017.

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	Asset Derivatives As of September 30, 2017		Asset Derivatives As of September 30, 2016		Liability Derivatives As of September 30, 2017		Liability Derivatives As of September 30, 2016	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments								
Interest Rate Products	Other Assets	\$ 548	Other Assets	\$	Other Liabilities	\$ 603	Other Liabilities	\$
Total derivatives not designated as hedging instruments		<u>\$ 548</u>		<u>\$</u>		<u>\$ 603</u>		<u>\$</u>

Non-designated Hedges

None of the Company's derivatives are designated in qualifying hedging relationships. Derivatives not designated as hedges are not speculative and result from a service the Company provides to certain customers, which the Company implemented during the third quarter of 2017. The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of September 30, 2017, the Company had 1 interest rate swap with an aggregate notional amount of \$34,000 related to this program.

Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Company's derivative financial instruments on the Income Statement for the three and nine months ended September 30, 2017.

	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative Three Months Ended September 30, 2017	Amount of Gain or (Loss) Recognized in Income on Derivative Nine Months Ended September 30, 2017
Derivatives Not Designated as Hedging Instruments			
Interest Rate Products	Other non-interest income	\$ (55)	\$ (55)
Total		<u>\$ (55)</u>	<u>\$ (55)</u>

Credit-risk-related Contingent Features

The Company has agreements with certain of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company also has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well capitalized institution, then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

The Company has agreements with certain of its derivative counterparties that contain provisions that require the Company's debt to maintain an investment grade credit rating from each of the major credit rating agencies. If the Company's credit rating is reduced below investment grade then a termination event shall be deemed to have occurred and the non-affected counterparty shall have the right but not obligation to terminate all affected transactions under the agreement.

As of September 30, 2017 the termination value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$55. The Company has minimum

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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collateral posting thresholds with certain of its derivative counterparties, and has posted collateral of \$760 against its obligations under these agreements. If the Company had breached any of these provisions at September 30, 2017, it could have been required to settle its obligations under the agreements at the termination value.

Peoples Financial Services Corp.
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Dollars in thousands, except share and per share data)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the unaudited consolidated interim financial statements contained in Part I, Item 1 of this report, and with our audited consolidated financial statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" presented in our Annual Report on Form 10-K for the year ended December 31, 2016.

Cautionary Note Regarding Forward-Looking Statements:

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

Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Important factors that could cause our actual results to differ materially from those in the forward-looking statements include, but are not limited to: changes in interest rates; economic conditions, particularly in our market area; legislative and regulatory changes and the ability to comply with the significant laws and regulations governing the banking and financial services business; monetary and fiscal policies of the U.S. government, including policies of the U.S. Department of Treasury and the Federal Reserve System; credit risk associated with lending activities and changes in the quality and composition of our loan and investment portfolios; demand for loan and other products; deposit flows; competition; changes in the values of real estate and other collateral securing the loan portfolio, particularly in our market area; our ability to achieve the intended benefits of, or other risks associated with, business combinations; changes in relevant accounting principles and guidelines; inability of third party service providers to perform; and our ability to prevent, detect and respond to cyberattacks. Additional factors that may affect our results are discussed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016, and in reports we file with the Securities and Exchange Commission from time to time.

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

Notes to the Consolidated Financial Statements referred to in the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") are incorporated by reference into the MD&A. Certain prior period amounts may have been reclassified to conform with the current year's presentation. Any reclassifications did not have any effect on the operating results or financial position of the Company.

Critical Accounting Policies:

Disclosure of our significant accounting policies are included in Note 1 to the consolidated financial statements of the Annual Report on Form 10-K for the year ended December 31, 2016. Some of these policies are particularly sensitive requiring significant judgments, estimates and assumptions. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policies upon which our financial condition and results of operation depend, and which involve the most complex subjective decisions or assessments, are included in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016, and all amendments thereto, as filed with the Securities and Exchange Commission.

Peoples Financial Services Corp.
MANAGEMENT'S DISCUSSION AND ANALYSIS
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Operating Environment:

The Federal Open Market Committee ("FOMC") increased the overnight rate 25 basis points during the first quarter of 2017 and another 25 basis points in the second quarter of 2017. In doing so, the FOMC cited improvement in labor markets and the a move toward the committee's long-term desired 2 percent level of inflation. The initial reading of third quarter 2017 gross domestic product ("GDP"), the value of all goods and services produced in the Nation, came in at an annualized rate of 3.0%, down from the final second quarter of 2017 estimate which came in at an annualized rate of 3.1% but up significantly from the final reading of 0.7% in the first quarter of 2017. The consumer price index ("CPI") increased for the 12 months ended September 30, 2017 at 2.2% from 1.6% for the 12 months ended June 30, 2017. The core personal consumption expenditure price index, which ignores food and energy, averaged 1.7% for both the 12 months ended September 30, 2017 and June 30, 2017.

Review of Financial Position:

Total assets increased \$92,794, or 6.2% annualized, to \$2,092,236 at September 30, 2017, from \$1,999,442 at December 31, 2016 due primarily to loan growth. Loans, net increased to \$1,632,515 at September 30, 2017, compared to \$1,532,965 at December 31, 2016, an increase of \$99,550 or 8.7% annualized. The increase in loans, net during 2017 has been funded primarily by deposit growth. Total deposits increased \$99,098 or 8.3% as interest-bearing deposits increased \$80,638 and noninterest-bearing deposits increased \$18,460. Investment securities decreased \$1,225 or 0.6% annualized in 2017. Total stockholders' equity increased \$9,678 or at an annual rate of 5.0%, from \$256,618 at year-end 2016 to \$266,296 at September 30, 2017. Compared to June 30, 2017, total assets increased \$27,478 or 1.3% while loans, net increased \$35,153 or 2.2% and deposits increased \$48,422 or 3.0%. For the nine months ended September 30, 2017, total assets averaged \$2,035,883, an increase of \$136,977 from \$1,898,906 for the same period of 2016.

Investment Portfolio:

The majority of the investment portfolio is held as available-for-sale, which allows for greater flexibility in using the investment portfolio for liquidity purposes by allowing securities to be sold when market opportunities occur. Investment securities available-for-sale totaled \$259,138 at September 30, 2017, a slight decrease of \$272, or 0.1% from \$259,410 at December 31, 2016. The majority of the investment cashflow from maturing bonds and principal payments on mortgage-backed securities was re-invested back into the investment portfolio. The Company has not incrementally grown the investment portfolio due to the flattening yield curve, however it continually monitors market rates for investment opportunities. Investment securities held-to-maturity totaled \$9,564 at September 30, 2017, a decrease of \$953 or 9.1% from \$10,517 at December 31, 2016 due to payments received from mortgage backed holdings.

For the nine months ended September 30, 2017, the investment portfolio averaged \$269,897, a decrease of \$2,627 or 1.0% compared to \$272,524 for the same period last year. The tax-equivalent yield on the investment portfolio decreased 6 basis points to 2.85% for the nine months ended September 30, 2017, from 2.91% for the comparable period of 2016. The decrease in the yield is resulting from investment cashflows being replaced into the low rate environment. The tax-equivalent yield on the investment portfolio decreased 4 basis points to 2.81% in the third quarter of 2017 compared to 2.85% in the second quarter of 2017.

Securities available-for-sale are carried at fair value, with unrealized gains or losses net of deferred income taxes reported in the accumulated other comprehensive income (loss) component of stockholders' equity. We reported net unrealized gains, included as a separate component of stockholders' equity of \$1,059, net of deferred income taxes of \$571, at September 30, 2017, and \$360, net of deferred income taxes of \$193, at December 31, 2016.

Our Asset/Liability Committee ("ALCO") reviews the performance and risk elements of the investment portfolio quarterly. Through active balance sheet management and analysis of the securities portfolio, we endeavor to maintain sufficient liquidity to satisfy depositor requirements and meet the credit needs of our customers.

Loan Portfolio:

The Company's execution and continued investment of its market expansion in the Lehigh Valley and King of Prussia markets of Pennsylvania has been the main contributor to the loan growth during the nine months ended September 30, 2017. Loans, net increased to \$1,632,515 at September 30, 2017 from \$1,532,965 at December 31, 2016, an increase of

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\$99,550 or 8.7% annualized. The growth reflected increases in commercial loans, commercial real estate loans and consumer loans, while residential real estate loans remained relatively unchanged. Commercial loans increased \$40,650, or 13.3% annualized, to \$449,464 at September 30, 2017 compared to \$408,814 at December 31, 2016. Commercial real estate loans increased \$51,366 or 9.8% annualized, to \$751,510 at September 30, 2017 compared to \$700,144 at December 31, 2016. Consumer loans increased \$7,733, or 7.7% on an annualized basis, to \$141,959 at September 30, 2017 compared to \$134,226 at December 31, 2016. The primary contributor to the growth in consumer loans was our indirect automobile lending portfolio which increased \$9,699, due to increased consumer demand for automobiles.

Residential real estate loans decreased \$199, or 0.9% on an annualized basis, to \$289,582 at September 30, 2017 compared to \$289,781 at December 31, 2016. The slight decrease is due to lower first lien residential mortgage loans as a higher percentage of new fixed rate originations were sold into the secondary market to mitigate interest rate risk in the current low rate environment in lieu of being retained in our loan portfolio. Growth in our home equity line of credit portfolio due to increased demand partially offset the decline.

For the nine months ended September 30, 2017, loans, net averaged \$1,570,268, an increase of \$132,688 or 9.2% compared to \$1,437,580 for the same period of 2016. The tax-equivalent yield on the loan portfolio was 4.39% for the nine months ended September 30, 2017, a 6 basis point decrease from the comparable period last year. The tax-equivalent yield on the loan portfolio increased to 4.42% for the third quarter of 2017 as compared to 4.36% for the second quarter of 2017 and 4.39% for the third quarter of 2016.

In addition to the risks inherent in our loan portfolio, in the normal course of business, we are also a party to financial instruments with off-balance sheet risk to meet the financing needs of our customers. These instruments include legally binding commitments to extend credit, unused portions of lines of credit and commercial letters of credit made under the same underwriting standards as on-balance sheet instruments, and may involve, to varying degrees, elements of credit risk and interest rate risk ("IRR") in excess of the amount recognized in the financial statements.

Unused commitments at September 30, 2017, totaled \$406,393, consisting of \$383,878 in unfunded commitments of existing loan facilities and \$22,515 in standby letters of credit. Due to fixed maturity dates, specified conditions within these instruments, and the ultimate needs of our customers, many will expire without being drawn upon. We believe that amounts actually drawn upon can be funded in the normal course of operations and therefore, do not represent a significant liquidity risk to us. In comparison, unused commitments at December 31, 2016 totaled \$324,713, consisting of \$293,662 in unfunded commitments of existing loans and \$31,051 in standby letters of credit.

Asset Quality:

National, Pennsylvania, New York and market area unemployment rates at September 30, 2017 and 2016, are summarized as follows:

	2017	2016
United States	4.4 %	4.9 %
New York (statewide)	4.6	4.9
Pennsylvania (statewide)	5.1	5.6
Broome County	5.6	5.5
Bucks County	4.4	4.8
Lackawanna County	5.4	5.9
Lehigh County	5.3	5.5
Luzerne County	6.2	6.6
Monroe County	6.2	6.5
Montgomery County	4.0	4.3
Northampton County	5.2	5.4
Susquehanna County	5.1	5.9
Wayne County	5.5	6.0
Wyoming County	5.6 %	6.5 %

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The employment conditions improved for the Nation, New York, and Pennsylvania, and improved in all but one of the eleven counties representing our market areas in Pennsylvania and New York from one year ago. Unemployment rates remained elevated however, relative to historical levels within many of our market areas. Additionally, the labor force participation rate, as measured on a national level, remains low at 63.1% as compared to pre-financial crisis levels.

We experienced improvement in our asset quality as nonperforming assets decreased for the nine months ended September 30, 2017 by \$631 or 4.4% to \$13,581 at September 30, 2017, from \$14,212 at December 31, 2016. We experienced decreases in nonaccrual and restructured loans and foreclosed assets which was partially offset by an increase to accruing loans past due 90 days or more. As a percentage of loans, net and foreclosed assets, nonperforming assets equaled 0.83% at September 30, 2017 and 0.93% at December 31, 2016.

Loans on nonaccrual status decreased \$2,387 to \$8,721 at September 30, 2017 from \$11,108 at December 31, 2016. The majority of the decrease from year end was due to a decrease of \$2,783 in nonaccrual commercial real estate loans which was due to the successful work-out and collection activities related to two large credit relationships. Increases in nonaccrual commercial and industrial loans of \$329, residential real estate loans of \$28 and consumer loans of \$39 partially offset the decrease. Other real estate owned decreased \$35 to \$358 at September 30, 2017 from \$393 at December 31, 2016, as eight properties were sold during the period with eight additional loans transferred to other real estate. At September 30, 2017 and December 31, 2016 there were eight properties comprising other real estate owned.

Generally, maintaining a high loan to deposit ratio is our primary goal in order to maximize profitability. However, this objective is superseded by our attempts to ensure that asset quality remains strong. We continue our efforts to maintain sound underwriting standards for both commercial and consumer credit. Most commercial lending is done primarily with locally owned small businesses.

We maintain the allowance for loan losses at a level we believe adequate to absorb probable credit losses related to specifically identified loans, as well as probable incurred loan losses inherent in the remainder of the loan portfolio as of the balance sheet date. The allowance for loan losses is based on past events and current economic conditions. We employ the Federal Financial Institutions Examination Council Interagency Policy Statement, as amended December 13, 2006, and GAAP in assessing the adequacy of the allowance account. Under GAAP, the adequacy of the allowance account is determined based on the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310, "Receivables," for loans specifically identified to be individually evaluated for impairment and the requirements of FASB ASC 450, "Contingencies," for large groups of smaller-balance homogeneous loans to be collectively evaluated for impairment.

We follow our systematic methodology in accordance with procedural discipline by applying it in the same manner regardless of whether the allowance is being determined at a high point or a low point in the economic cycle. Each quarter, credit administration identifies those loans to be individually evaluated for impairment and those loans collectively evaluated for impairment utilizing a standard criteria. We consistently use loss experience from the latest twelve quarters in determining the historical loss factor for each pool collectively evaluated for impairment. Qualitative factors are evaluated in the same manner each quarter and are adjusted within a relevant range of values based on current conditions. For additional disclosure related to the allowance for loan losses refer to the note entitled, "Loans, net and Allowance for Loan Losses," in the Notes to Consolidated Financial Statements to this Quarterly Report.

The allowance for loan losses increased \$2,870 to \$18,831 at September 30, 2017, from \$15,961 at the end of 2016. For the nine months ended September 30, 2017, net charge-offs were \$730 or 0.06% of average loans outstanding, a \$133 decrease compared to \$863 or 0.08% of average loans outstanding in the same period of 2016.

Deposits:

We attract the majority of our deposits from within our eleven county market area that stretches from Bucks and Montgomery Counties in southeastern Pennsylvania to Broome County in the Southern Tier of New York State through the offering of various deposit instruments including demand deposit accounts, NOW accounts, money market deposit accounts, savings accounts, and time deposits, including certificates of deposit and IRA's. For the nine months ended September 30, 2017, total deposits increased to \$1,687,855 from \$1,588,757 at December 31, 2016. Interest-bearing deposits increased \$80,638 and noninterest-bearing deposits increased \$18,460. Interest-bearing transaction accounts,

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including NOW and money market accounts, increased \$85,584, or 20.6% annualized, to \$640,912 at September 30, 2017, from \$555,328 at December 31, 2016. Increases in NOW and money market account balances is due to growth in the company's public fund deposit base and growth in its expansion markets. Time deposits less than \$100 decreased \$7,475, or 6.1% annualized, to \$156,675 at September 30, 2017, from \$164,150 at December 31, 2016. Decreases in savings accounts of \$3,970 and increases in time deposits \$100 or more of \$6,499 were recorded in the nine months ended September 30, 2017.

For the nine months ended September 30, 2017 interest-bearing deposits averaged \$1,271,584 in 2017 compared to \$1,176,631 in 2016. The cost of interest-bearing deposits was 0.49% in 2017 compared to 0.45% for the same period last year. For the first nine months, the overall cost of interest-bearing liabilities including the cost of borrowed funds, was 0.60% in 2017 compared to 0.55% in 2016. The higher cost is due primarily to higher short-term market rates, the result of the FOMC's action to increase the overnight borrowing rate 50 basis points during the nine months ended September 30, 2017. The cost of interest-bearing liabilities increased 1 basis point when comparing the second and third quarters of 2017.

Borrowings:

The Bank utilizes borrowings as a secondary source of liquidity for its asset/liability management. Advances are available from the Federal Home Loan Bank of Pittsburgh ("FHLB) provided certain standards related to credit worthiness have been met. Repurchase and term agreements are also available from the FHLB.

Total short-term borrowings at September 30, 2017, totaled \$71,900 compared to \$82,700 at December 31, 2016, a decrease of \$10,800. Long-term debt was \$50,199 at September 30, 2017, compared to \$58,134 at year end 2016. The decrease in short-term borrowings was a function of strong deposit growth funding our loan demand, whereas the decline in long-term debt was a product of monthly contractual amortized payments and the maturity of a term borrowing during the nine months ended September 30, 2017.

Market Risk Sensitivity:

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

As a result of economic uncertainty and a prolonged era of historically low market rates, it has become challenging to manage IRR. Due to these factors, IRR and effectively managing it are very important to both bank management and regulators. Bank regulations require us to develop and maintain an IRR management program, overseen by the Board of Directors and senior management, that involves a comprehensive risk management process in order to effectively identify, measure, monitor and control risk. Should bank regulatory agencies identify a material weakness in our risk management process or high exposure relative to our capital, bank regulatory agencies may take action to remedy these shortcomings. Moreover, the level of IRR exposure and the quality of our risk management process is a determining factor when evaluating capital adequacy.

The ALCO, comprised of members of our Board of Directors, senior management and other appropriate officers, oversees our IRR management program. Specifically, ALCO analyzes economic data and market interest rate trends, as well as competitive pressures, and utilizes computerized modeling techniques to reveal potential exposure to IRR. This

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allows us to monitor and attempt to control the influence these factors may have on our rate-sensitive assets ("RSA") and rate-sensitive liabilities ("RSL"), and overall operating results and financial position. One such technique utilizes a static gap model that considers repricing frequencies of RSA and RSL in order to monitor IRR. Gap analysis attempts to measure our interest rate exposure by calculating the net amount of RSA and RSL that reprice within specific time intervals. A positive gap occurs when the amount of RSA repricing in a specific period is greater than the amount of RSL repricing within that same time frame and is indicated by a RSA/RSL ratio greater than 1.0. A negative gap occurs when the amount of RSL repricing is greater than the amount of RSA and is indicated by a RSA/RSL ratio of less than 1.0. A positive gap implies that earnings will be impacted favorably if interest rates rise and adversely if interest rates fall during the period. A negative gap tends to indicate that earnings will be affected inversely to interest rate changes.

Our cumulative one-year RSA/RSL ratio equaled 1.65% at September 30, 2017. Given the length of time that market rates have been at historical lows and the potential for rates to increase in the future, the focus of ALCO has been to create a positive static gap position. With regard to RSA, we predominantly offer medium- term, fixed-rate loans as well as adjustable rate loans. With respect to RSL, we offer longer term promotional certificates of deposit in an attempt to increase duration. The current position at September 30, 2017, indicates that the amount of RSA repricing within one year would exceed that of RSL, thereby causing net interest income to increase as market rates increase. However, these forward-looking statements are qualified in the aforementioned section entitled "Forward-Looking Discussion" in this Management's Discussion and Analysis.

Static gap analysis, although a standard measuring tool, does not fully illustrate the impact of interest rate changes on future earnings. First, market rate changes normally do not equally or simultaneously affect all categories of assets and liabilities. Second, assets and liabilities that can contractually reprice within the same period may not do so at the same time or to the same magnitude. Third, the interest rate sensitivity table presents a one-day position. Variations occur daily as we adjust our rate sensitivity throughout the year. Finally, assumptions must be made in constructing such a table.

As the static gap report fails to address the dynamic changes in the balance sheet composition or prevailing interest rates, we utilize a simulation model to enhance our asset/liability management. This model is used to create pro forma net interest income scenarios under various interest rate shocks. Model results at September 30, 2017, produced results similar to those indicated by the one-year static gap position. In addition, parallel and instantaneous shifts in interest rates under various interest rate shocks resulted in changes in net interest income that were well within ALCO policy limits. We will continue to monitor our IRR throughout 2017 and endeavor to employ deposit and loan pricing strategies and direct the reinvestment of loan and investment repayments in order to manage our IRR position.

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

Liquidity:

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

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

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These obligations are managed daily, thus enabling us to effectively monitor fluctuations in our liquidity position and to adapt that position according to market influences and balance sheet trends. Future liquidity needs are forecasted and strategies are developed to ensure adequate liquidity at all times.

Historically, core deposits have been the primary source of liquidity because of their stability and lower cost, in general, than other types of funding. Providing additional sources of funds are loan and investment payments and prepayments and the ability to sell both available for sale securities and mortgage loans held for sale. We believe liquidity is adequate to meet both present and future financial obligations and commitments on a timely basis.

We employ a number of analytical techniques in assessing the adequacy of our liquidity position. One such technique is the use of ratio analysis to determine the extent of our reliance on noncore funds to fund our investments and loans maturing after September 30, 2017. Our noncore funds at September 30, 2017, were comprised of time deposits in denominations of \$100 or more and other borrowings. These funds are not considered to be a strong source of liquidity because they are very interest rate sensitive and are considered to be highly volatile. At September 30, 2017, our net noncore funding dependence ratio, the difference between noncore funds and short-term investments to long-term assets, was 13.6%, while our net short-term noncore funding dependence ratio, noncore funds maturing within one-year, less short-term investments to long-term assets equaled 6.5%. Comparatively, our overall noncore dependence ratio at year-end 2016 was 14.4% and our net short-term noncore funding dependence ratio was 6.5%, indicating that our reliance on noncore funds has decreased.

The Consolidated Statements of Cash Flows present the changes in cash and cash equivalents from operating, investing and financing activities. Cash and cash equivalents, consisting of cash on hand, cash items in the process of collection, deposit balances with other banks and federal funds sold, decreased \$7,035 during the nine months ended September 30, 2017. Cash and cash equivalents decreased \$1,003 for the same period last year. For the nine months ended September 30, 2017, net cash inflows of \$22,720 from operating activities and \$73,411 from financing activities were more than offset by net cash outflows of \$103,166 from investing activities. For the same period of 2016, net cash inflows of \$20,663 from operating activities and \$137,823 from financing activities were more than offset by net cash outflows of \$159,489 from investing activities.

Operating activities provided net cash of \$22,720 for the nine months ended September 30, 2017, and \$20,663 for the corresponding nine months of 2016. Net income, adjusted for the effects of gains and losses along with noncash transactions such as depreciation and the provision for loan losses, is the primary source of funds from operations.

Investing activities primarily include transactions related to our lending activities and investment portfolio. Investing activities used net cash of \$103,166 for the nine months ended September 30, 2017, compared to using \$159,489 for the same period of 2016. In 2017, an increase in lending activities was the primary factor causing the net cash outflow from investing activities. In 2016, lending also led to the decrease in cash from investing activities and was only partially offset by proceeds received from investment securities.

Financing activities provided net cash of \$73,411 for the nine months ended September 30, 2017, and \$137,823 for the corresponding nine months of 2016. Deposit gathering is our predominant financing activity. Deposits increased for the nine months ended September 30, 2017 and 2016. The increase in deposits totaled \$99,098 in the nine months ended September 30, 2017. Comparatively, deposits increased \$110,000 for the same period of 2016. We continued to attract deposits from customers in new markets as well as existing customers, including municipalities and school districts. Another source of financing is our short term borrowings. Short term borrowings decreased \$10,800 in the nine months ended September 30, 2017 compared to an increase of \$36,975 in the same nine months period in 2016 due to higher loan growth.

We believe that our future liquidity needs will be satisfied through maintaining an adequate level of cash and cash equivalents, by maintaining readily available access to traditional funding sources, and through proceeds received from the investment and loan portfolios. The current sources of funds will enable us to meet all cash obligations as they come due.

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Capital:

Stockholders' equity totaled \$266,296 or \$36.00 per share at September 30, 2017, compared to \$256,618 or \$34.71 per share at December 31, 2016. Net income of \$15,809 for the nine months ended September 30, 2017 was the primary factor leading to the improved capital position. Stockholders' equity was also affected by cash dividends declared of \$6,952, stock based compensation of \$122, and other comprehensive income resulting from market value fluctuations in the investment portfolio of \$699.

Dividends declared equaled \$0.94 per share through nine months of 2017 and \$0.93 per share through the nine months of 2016. The dividend payout ratio was 43.9% for the nine months ended September 30, 2017 and 46.3% for the same period of 2016. The merger agreement pursuant to which we merged with Pensco in 2013 contemplates that, unless 80 percent of our board of directors determines otherwise, we will pay a quarterly cash dividend in an amount no less than \$0.31 per share through 2018, provided that sufficient funds are legally available, and that we remain "well-capitalized" in accordance with applicable regulatory guidelines. It is the intention of our board of directors to continue to pay cash dividends in the future. However, these decisions are affected by operating results, financial and economic decisions, capital and growth objectives, appropriate dividend restrictions and other relevant factors.

In July 2013, the Board of Governors of the FRB approved the Basel III interim final rule ("Basel III") which is intended to strengthen the quality and increase the required level of regulatory capital for a more stable and resilient banking system. The changes include: (i) a new regulatory capital measure, Common Equity Tier 1 ("CET1"), which is limited to capital elements of the highest quality; (ii) a new definition and increase of tier 1 capital which is now comprised of CET1 and Additional Tier 1; (iii) changes in calculation of some risk-weighted assets and off-balance sheet exposure; and (iv) a capital conservation buffer that will limit capital distributions, stock redemptions, and certain discretionary bonus payments if the institution does not maintain capital in excess of the minimum capital requirements. These new capital rules took effect for our Bank on January 1, 2015 and reporting began with the quarter ended June 30, 2015. Under the final capital rules that became effective on January 1, 2015, there was a requirement for a CET1 capital conservation buffer of 2.5% of risk-weighted assets which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain this required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement is being phased in over three years beginning in 2016.

The adequacy of capital is reviewed on an ongoing basis with reference to the size, composition and quality of resources and regulatory guidelines. We seek to maintain a level of capital sufficient to support existing assets and anticipated asset growth, maintain favorable access to capital markets, and preserve high quality credit ratings. At September 30, 2017, the Bank's Tier 1 capital to total average assets was 9.74% as compared to 9.88% at December 31, 2016. The Bank's Tier 1 capital to risk weighted asset ratio was 11.60% and the total capital to risk weighted asset ratio was 12.73% at September 30, 2017. These ratios were 12.14% and 13.16% at December 31, 2016. The Bank's common equity Tier 1 to risk weighted asset ratio was 11.60% at September 30, 2017 compared to 12.14% at December 31, 2016. The Bank was deemed to be well-capitalized under regulatory standards at September 30, 2017. Additionally, as of September 30, 2017, the Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if all such requirements were currently in effect.

Review of Financial Performance:

Net income for the third quarter of 2017 equaled \$5,350 or \$0.72 per share compared to \$5,118 or \$0.69 per share for the third quarter of 2016. Return on average assets ("ROA") measures our net income in relation to total assets. Our ROA was 1.03% for the third quarter of 2017 and 1.05% for the same period in 2016. Return on average equity ("ROE") indicates how effectively we can generate net income on the capital invested by stockholders. Our ROE was 8.00% for the third quarter of 2017 compared to 7.95% for the third quarter of 2016. Net income through nine months in 2017 equaled \$15,809 or \$2.14 per share compared to \$14,855 or \$2.01 per share for the same period of 2016. Our ROA and ROE were 1.04% and 8.09% through nine months in 2017 compared to 1.04% and 7.76% for the same period of 2016. There were no gains on sale of investment securities for the nine months ended September 30, 2017 while there were gains of \$623 for the same period in 2016. In the second quarter of 2017, we entered into and executed a merchant asset purchase agreement with a third party to sell and transfer our merchant business. This sale resulted in a gain of \$2,278.

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There was no comparable gain in the corresponding period of 2016. In conjunction with the sale, we also executed a marketing and sales agreement to share in the future revenue generated from the sold merchant portfolio, and from new merchant referrals. The sale represents the entirety of our merchant services business and we will no longer originate any proprietary merchant services relationships, nor did we receive an ownership interest in the unrelated purchaser of that business.

Net Interest Income:

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

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

Changes in net interest income are measured by the net interest spread and net interest margin. Net interest spread, the difference between the average yield earned on earning assets and the average rate incurred on interest-bearing liabilities, illustrates the effects changing interest rates have on profitability. Net interest margin, net interest income as a percentage of earning assets, is a more comprehensive ratio, as it reflects not only the spread, but also the change in the composition of interest-earning assets and interest-bearing liabilities. Tax-exempt loans and investments carry pre-tax yields lower than their taxable counterparts. Therefore, in order to make the analysis of net interest income more comparable, tax-exempt income and yields are reported herein on a tax-equivalent basis using the prevailing federal statutory tax rate of 35.0% in 2017 and 2016.

For the three months ended September 30, tax-equivalent net interest income increased \$900 to \$17,479 in 2017 from \$16,579 in 2016. The net interest spread decreased to 3.58% for the three months ended September 30, 2017 from 3.63% for the three months ended September 30, 2016. The tax-equivalent net interest margin decreased to 3.73% for the third quarter of 2017 from 3.76% for the comparable period of 2016. The tax-equivalent net interest margin for the second quarter of 2017 was 3.68%.

For the three months ended September 30, tax-equivalent interest income on earning assets increased \$1,250, to \$19,654 in 2017 as compared to \$18,404 in 2016. The overall yield on earning assets, on a fully tax-equivalent basis, increased 2 basis points for the three months ended September 30, 2017 to 4.19% as compared to 4.17% for the three months ended September 30, 2016. The increase in the yield on earning assets resulted from a 3 basis point increase in loan yields, 4.42% for the third quarter of 2017 compared to 4.39% for the same period last year. The overall yield earned on investments decreased 13 basis points for the third quarter of 2017 to 2.81% from 2.94% for the third quarter of 2016. Average investment balances were slightly higher when comparing the current and year ago quarter.

Total interest expense increased \$350, to \$2,175 for the three months ended September 30, 2017 from \$1,825 for the three months ended September 30, 2016. An unfavorable volume variance caused the increase. An increase in the average volume of interest bearing liabilities of \$76,435 coupled with a 7 basis point increase in the cost of funds comparing the three months ended September 30, 2017 and 2016 caused the increase.

For the nine months ended September 30, tax-equivalent net interest income increased \$2,505 to \$51,109 in 2017 from \$48,604 in 2016. The net interest spread decreased to 3.57% for the nine months ended September 30, 2017 from 3.66% for the nine months ended September 30, 2016. The tax-equivalent net interest margin for the nine months ended September 30 was 3.71% in 2017 compared to 3.79% in 2016.

For the nine months ended September 30, 2017, tax-equivalent interest income increased \$3,452, to \$57,366 compared to \$53,914 for the nine months ended September 30, 2016. A volume variance in interest income of \$4,381 attributable to an increase in the average balance of earning assets was partially offset by a \$929 unfavorable rate variance due primarily to a decrease in the yield on loans. Specifically, the increase was primarily due to a \$132,688 increase in

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average loans for the nine months ended September 30, 2017 from the same period in 2016. The overall yield on earning assets, on a fully tax-equivalent basis, decreased for the nine months ended September 30, 2017 to 4.17% as compared to 4.21% for the nine months ended September 30, 2016. This was a result of increased market competition for new loans.

Total interest expense increased \$947 to \$6,257 for the nine months ended September 30, 2017 from \$5,310 for the nine months ended September 30, 2016. A volume variance caused interest expenses to increase \$298. The average volume of interest bearing liabilities increased to \$1,403,250 for the nine months ended September 30, 2017, as compared to \$1,301,253 for the nine months ended September 30, 2016. Adding to the volume variance, a rate variance of \$649 resulted in the increased interest expense through nine months in 2017. The cost of funds increased to 0.60% for the nine months ended September 30, 2017 as compared to 0.55% for the same period in 2016.

The average balances of assets and liabilities, corresponding interest income and expense and resulting average yields or rates paid are summarized as follows. Averages for earning assets include nonaccrual loans. Investment averages include available-for-sale securities at amortized cost. Income on investment securities and loans is adjusted to a tax equivalent basis using the prevailing federal statutory tax rate of 35%.

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	Three months ended					
	September 2017			September 2016		
	Average Balance	Interest Income/Interest	Yield/Rate	Average Balance	Interest Income/Interest	Yield/Rate
Assets:						
Earning assets:						
Loans:						
Taxable	\$ 1,482,215	\$ 16,535	4.43 %	\$ 1,385,801	\$ 15,294	4.39 %
Tax-exempt	114,455	1,250	4.33	108,104	1,185	4.36
Investments:						
Taxable	157,104	766	1.93	136,645	598	1.74
Tax-exempt	106,865	1,102	4.09	123,177	1,325	4.28
Interest-bearing deposits	272	1	1.46	412	2	1.93
Federal funds sold						
Total earning assets	1,860,911	19,654	4.19 %	1,754,139	18,404	4.17 %
Less: allowance for loan losses	18,180			15,168		
Other assets	213,953			203,425		
Total assets	<u>\$ 2,056,684</u>	<u>\$ 19,654</u>		<u>\$ 1,942,396</u>	<u>\$ 18,404</u>	
Liabilities and Stockholders' Equity:						
Interest-bearing liabilities:						
Money market accounts	\$ 273,482	\$ 397	0.58 %	\$ 225,214	\$ 225	0.40 %
NOW accounts	342,516	375	0.43	302,026	299	0.39
Savings accounts	399,639	127	0.13	394,538	177	0.18
Time deposits less than \$100	156,012	420	1.07	160,872	409	1.01
Time deposits \$100 or more	128,012	335	1.04	112,996	246	0.87
Short-term borrowings	54,084	177	1.30	78,974	116	0.58
Long-term debt	56,270	344	2.43	58,960	353	2.38
Total interest-bearing liabilities	1,410,015	2,175	0.61	1,333,580	1,825	0.54
Noninterest-bearing deposits	366,610			337,337		
Other liabilities	14,820			15,349		
Stockholders' equity	265,239			256,130		
Total liabilities and stockholders' equity	<u>\$ 2,056,684</u>	<u>2,175</u>		<u>\$ 1,942,396</u>	<u>1,825</u>	
Net interest income/spread		<u>\$ 17,479</u>	<u>3.58 %</u>		<u>\$ 16,579</u>	<u>3.63 %</u>
Net interest margin			3.73 %			3.76 %
Tax-equivalent adjustments:						
Loans		\$ 437			\$ 415	
Investments		386			464	
Total adjustments		<u>\$ 823</u>			<u>\$ 879</u>	

Peoples Financial Services Corp.
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Dollars in thousands, except share and per share data)

	Nine months ended					
	September 2017			September 2016		
	Average Balance	Interest Income/Interest	Yield/Rate	Average Balance	Interest Income/Interest	Yield/Rate
Assets:						
Earning assets:						
Loans:						
Taxable	\$ 1,458,840	\$ 48,021	4.40 %	\$ 1,330,166	\$ 44,400	4.46 %
Tax-exempt	111,428	3,591	4.31	107,414	3,540	4.40
Investments:						
Taxable	158,837	2,271	1.91	146,734	1,911	1.74
Tax-exempt	111,060	3,480	4.19	125,790	4,017	4.27
Interest-bearing deposits	309	3	1.30	1,808	46	3.40
Federal funds sold						
Total earning assets	1,840,474	57,366	4.17 %	1,711,912	53,914	4.21 %
Less: allowance for loan losses	17,309			14,381		
Other assets	212,718			201,375		
Total assets	<u>\$2,035,883</u>	<u>\$ 57,366</u>		<u>\$1,898,906</u>	<u>\$ 53,914</u>	
Liabilities and Stockholders' Equity:						
Interest-bearing liabilities:						
Money market accounts	\$ 256,632	\$ 1,003	0.52 %	\$ 215,747	\$ 605	0.37 %
NOW accounts	331,653	1,057	0.43	295,906	843	0.38
Savings accounts	400,585	380	0.13	391,830	525	0.18
Time deposits less than \$100	158,230	1,265	1.07	163,395	1,283	1.05
Time deposits \$100 or more	124,484	912	0.98	109,753	705	0.86
Short-term borrowings	74,506	599	1.07	65,117	282	0.58
Long-term debt	57,160	1,041	2.43	59,505	1,067	2.40
Total interest-bearing liabilities	1,403,250	6,257	0.60	1,301,253	5,310	0.55
Noninterest-bearing deposits	356,560			326,434		
Other liabilities	14,666			15,420		
Stockholders' equity	261,407			255,799		
Total liabilities and stockholders' equity	<u>\$2,035,883</u>	<u>6,257</u>		<u>\$1,898,906</u>	<u>5,310</u>	
Net interest income/spread		<u>\$ 51,109</u>	3.57 %		<u>\$ 48,604</u>	3.66 %
Net interest margin			3.71 %			3.79 %
Tax-equivalent adjustments:						
Loans		\$ 1,257			\$ 1,239	
Investments		1,218			1,406	
Total adjustments		<u>\$ 2,475</u>			<u>\$ 2,645</u>	

Provision for Loan Losses:

We evaluate the adequacy of the allowance for loan losses account on a quarterly basis utilizing our systematic analysis in accordance with procedural discipline. We take into consideration certain factors such as composition of the loan portfolio, volumes of nonperforming loans, volumes of net charge-offs, prevailing economic conditions and other relevant factors when determining the adequacy of the allowance for loan losses account. We make monthly provisions to the allowance for loan losses account in order to maintain the allowance at the appropriate level indicated by our evaluations. Based on our most current evaluation, we believe that the allowance is adequate to absorb any known and inherent losses in the portfolio as of September 30, 2017.

Peoples Financial Services Corp.
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Dollars in thousands, except share and per share data)

For the three and nine months ended September 30, 2017 and 2016, the provision for loan losses totaled \$1,200 and \$3,600.

Noninterest Income:

Noninterest income for the third quarter decreased \$364 or 9.0% to \$3,661 in 2017 from \$4,025 in 2016. For the nine months ended September 30, 2017, noninterest income totaled \$13,822, an increase of \$1,793 or 14.9% from \$12,029 for the comparable period of 2016. Service charges, fees and commissions increased \$897, or 20.0% to \$5,410 through nine months in 2017 from \$4,513 for the same period in 2016. Included in service charges, fees and commissions was a net fee of \$496 recognized in September of 2017 related to an interest rate swap transaction we entered into with a large commercial credit customer. Income generated from commissions and fees on fiduciary activities increased \$47 to \$1,542 for the nine months ended September 30, 2017 in comparison to \$1,495 for the same period in 2016 due to additional executor fees generated in 2017. Income generated from our wealth management division increased \$102, or 10.4% to \$1,081 through nine months in 2017 compared to \$979 over that same period in 2016 due to the build out of our wealth management division in 2017. Merchant services income decreased \$851, or 26.5% to \$2,358 for the nine months ended September 30, 2017 from \$3,209 for the same period last year due to the sale of our merchant services business in the second quarter of 2017. Mortgage banking income decreased \$40 to \$576 through nine months in 2017 compared to \$616 for the comparable period in 2016 as the volume of loans originated for sale declined. Life insurance investment income decreased \$17 to \$577 for the nine months ended September 30, 2017 from \$594 for the same period in 2016. There were no gains from the sale of investment securities available-for-sale for the nine months ended September 30, 2017 compared to \$623 for the same period in 2016. As previously mentioned, the nine months ended September 30, 2017 included a gain from the sale of our merchant business in the amount of \$2,278. The nine month period ending September 30, 2016 did not have a comparable transaction.

For the three months ended September 30, the decrease was due primarily to lower merchant services income of \$1,092, the result of the sale of our merchant business during the second quarter of 2017. Mortgage banking income and life insurance income also declined. Higher service charges, fees and commission of \$614 due primarily to the interest rate swap executed in the current period, and higher wealth management income of \$143 due to our build-out of the division partially offset the decreases.

Noninterest Expenses:

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

For the third quarter, noninterest expense increased \$463 or 3.9% to \$12,480 in 2017 from \$12,017 in 2016. For the nine months ended September 30, noninterest expense increased \$3,090 or 8.6% to \$38,838 in 2017 from \$35,748 in 2016. Personnel costs increased 18.9%, net occupancy and equipment costs increased 4.7%, merchant services expense decreased 20.9% and other expenses increased by 2.3% comparing year-to-date 2017 and 2016.

Salaries and employee benefits expense, which comprise the majority of noninterest expense, totaled \$6,550 for the third quarter of 2017, an increase of \$1,084 or 19.8% when compared to the third quarter of 2016. Salaries and employee benefits expense totaled \$19,851 for the nine months ending September 30, 2017, an increase of \$3,149 or 18.9% when compared to the same period of 2016. Additional resources in support our market expansion in the Lehigh Valley and King of Prussia was the primary reason for the increase. Merit increases and higher health insurance costs also contributed to the increases in the three and nine month periods.

Peoples Financial Services Corp.
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Dollars in thousands, except share and per share data)

The Company experienced a \$167 or 7.2% increase in net occupancy and equipment expense comparing \$2,483 for the third quarter of 2017 and \$2,316 for the third quarter of 2016. We experienced a \$329 or 4.7% increase in net occupancy and equipment expense comparing \$7,327 for the nine months ended September 30, 2017 and \$6,998 for the same period in 2016. The addition of two offices in our expansion market during 2017 increased our branch network and resulted in higher expenditures for occupancy and equipment related projects when compared to the year ago period. In general, as we expand and increase our presence in new markets, the costs associated with the maintenance and upkeep of new infrastructure within those markets increases.

Merchant services expense decreased \$857 to \$33 for the three months ended September 30, 2017 from \$890 for the same period in 2016. Merchant services expense decreased \$474 or 20.9% to \$1,796 for the nine months ended September 30, 2017 from \$2,270 for the same period in 2016. The decreases in both the three and nine months periods relates directly to the sale of our merchant services business at the end of the second quarter of 2017. The merchant asset sales agreement we entered into and executed transferred our merchant business and substantially reduced the related costs.

For the third quarter, other expenses increased \$107 or 3.5% to \$3,155 from \$3,048 comparing 2017 to 2016. For the three months ended September 30, 2017, account processing costs associated with fees related to loan originations were higher by \$134. For the nine months ended September 30, other expenses increased \$200 or 2.3% to \$9,079 in 2017 compared to \$8,879 in 2016. Consulting and advisory expenses were higher by \$225 due to costs related to the sale of the merchant business and costs incurred for loan reviews by an outside third party. Accounting and auditing expenses were higher by \$151 during the current nine months ended September 30, 2017 due to our transition to a new external auditing firm.

Income Taxes:

We recorded income tax expense of \$1,287 or 19.4% of pre-tax income, and \$1,390 or 21.4% of pre-tax income for the three months ended September 30, 2017 and 2016. We recorded income tax expense of \$4,209 or 21.0% of pre-tax income for the nine months ended September 30, 2017 and \$3,785 or 20.3% of pre-tax income for the comparable period in 2016. The nine months ended September 30, 2017 includes investment tax credits of \$819 compared to \$1,128 for that same period last year. Additionally, a higher proportion of tax-exempt interest income to before tax income was recognized during the year ago period.

Peoples Financial Services Corp.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

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

A bank with a high degree of IRR may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities.

The projected impacts of instantaneous changes in interest rates on our net interest income and economic value of equity at September 30, 2017, based on our simulation model, as compared to our ALCO policy limits are summarized as follows:

Changes in Interest Rates (basis points)	September 30, 2017 % Change in			
	Net Interest Income		Economic Value of Equity	
	Metric	Policy	Metric	Policy
+400	3.2	(20.0)	6.3	(40.0)
+300	2.6	(20.0)	5.3	(30.0)
+200	1.9	(10.0)	3.8	(20.0)
+100	1.2	(10.0)	3.1	(10.0)
Static				
-100	(5.4)	(10.0)	(10.5)	(10.0)

Our simulation model creates pro forma net interest income scenarios under various interest rate shocks. Given instantaneous and parallel shifts in general market rates of plus 100 basis points, our projected net interest income for the 12 months ending September 30, 2017, would increase 1.2 percent from model results using current interest rates. Additional disclosures about market risk are included in Part I, Item 2 of this quarterly report and Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2016, under the heading “Market Risk Sensitivity,” and are incorporated into this Item 3 by reference. There were no material changes in our market risk from December 31, 2016.

Item 4. Controls and Procedures.

(a) Evaluation of disclosure controls and procedures.

At September 30, 2017, the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer (“PEO”) and principal financial officer (“PFO”) evaluated the effectiveness of the Company’s disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, the PEO and PFO concluded that the disclosure controls and procedures, at September 30, 2017, were effective to provide reasonable assurance that information required to be disclosed in the Company’s reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and to provide

Peoples Financial Services Corp.

reasonable assurance that information required to be disclosed in such reports is accumulated and communicated to the PEO and PFO to allow timely decisions regarding required disclosure.

(b) Changes in internal control.

There were no changes made in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

The nature of the Company's business generates a certain amount of litigation involving matters arising out of the ordinary course of business. In the opinion of management, there were no legal proceedings that had or might have a material effect on the consolidated results of operations, liquidity, or the financial position of the Company during the period ended September 30, 2017 and through the date of this quarterly report on Form 10-Q and no such legal proceedings known to be contemplated by governmental authorities.

Item 1A. Risk Factors .

There have been no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information .

None.

Item 6. Exhibits .

31.1 Principal Executive Officer certification pursuant to Rule 13a-14(a)/15d-14(a).

31.2 Principal Financial Officer certification pursuant to Rule 13a-14(a)/15d-14(a).

32 Principal Executive Officer and Principal Financial Officer certifications pursuant to Section 1350.

101+ Interactive Data File

+ As provided in Rule 406T of Regulation S-T, this information is filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

Peoples Financial Services Corp.**EXHIBIT INDEX**

Item Number	Description	Page
31.1	Principal Executive Officer Certification Pursuant to Rule 13a-14 (a) /15d-14 (a).	50
31.2	Principal Financial Officer Certification Pursuant to Rule 13a-14 (a) /15d-14 (a).	51
32	Principal Executive Officer and Principal Financial Officer Certifications Pursuant to Section 1350.	52
101	The following materials from Peoples Financial Services Corp. Quarterly Report on Form 10-Q for the period ended September 30, 2017, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income and Comprehensive Income, (iii) the Consolidated Statements of Changes in Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to the unaudited Consolidated Financial Statements.	

Peoples Financial Services Corp.

SIGNATURES

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

Peoples Financial Services Corp.
(Registrant)

Date: November 7, 2017

/s/ Craig W. Best
Craig W. Best
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 7, 2017

/s/ John R. Anderson, III
John R. Anderson, III
Interim Principal Financial and Accounting Officer
(Interim Principal Financial Officer and Principal Accounting Officer)

CERTIFICATION

I, Craig W. Best, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended September 30, 2017, of Peoples Financial Services Corp.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13A-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in the quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Craig W. Best

President and Chief Executive Officer
(Principal Executive Officer)

Date: November 7, 2017

CERTIFICATION

I, John R. Anderson, III, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended September 30, 2017, of Peoples Financial Services Corp.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13A-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in the quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ John R. Anderson, III

Interim Principal Financial and Accounting Officer
(Interim Principal Financial Officer and Principal Accounting Officer)

Date: November 7, 2017

SECTION 1350 CERTIFICATIONS

In connection with the Quarterly Report on Form 10-Q of Peoples Financial Services Corp. (the “Company”) for the period ended September 30, 2017, as filed with the Securities and Exchange Commission (the “Report”), I, Craig W. Best, President and Chief Executive Officer, of the Company, certify, pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly represents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

/s/ Craig W. Best

President and Chief Executive Officer
(Principal Executive Officer)
Date: November 7, 2017

/s/ John R. Anderson, III

Interim Principal Financial and Accounting Officer
(Interim Principal Financial Officer and Principal Accounting Officer)
Date: November 7, 2017

A signed copy of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.