UNITED BANCSHARES INC/OH
Form 10-K
March 02, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934, as amended
For the fiscal year ended December 31, 2017
Commission File No.: 000-29283

UNITED BANCSHARES, INC.
(exact name of registrant as specified in its charter)

OHIO	34-1516518
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer I.D. No.)

105 Progressive Drive, Columbus Grove, Ohio 45830
(Address of principal executive offices)
Registrant's telephone number, including area code: (419) 659-2141
Securities registered pursuant to Section 12(b) of the Act:
Common Stock, no par value — NASDAQ Global Market
(Title of class)

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller Reporting Company
			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 Act). Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant was $69,028,312, based upon the last sales price as quoted on the NASDAQ Global Market as of June 30, 2017.

The number of shares of Common Stock, no par value outstanding as of January 31, 2018: 3,267,945

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Annual Report to Shareholders for the fiscal year ended December 31, 2017 are incorporated by reference into Part II. Portions of the Corporation’s definitive proxy statement relating to the Annual Meeting of Shareholders to be held on April 25, 2018 are incorporated by reference into Part III.

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Forward Looking Statements

From time to time, we have made or will make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements do not relate strictly to historical or current facts. Forward-looking statements usually can be identified by the use of words such as "goal," "objective," "outlook," "plan," "strategy," "expect," "anticipate," "project," "believe," "estimate," or other words of similar meaning, or by words or phrases indicating that an event or trend "may," "should," "will," "is likely," or that an event or trend is "probable" to occur or "continu has "begun," "is scheduled," or is "on track." Forward-looking statements provide our current expectations or forecasts of future events, circumstances, results or aspirations. Our disclosures in this report contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make forward-looking statements in our other documents filed with or furnished to the Securities and Exchange Commission (the "SEC"). Forward-looking statements are not historical facts and, by their nature, are subject to assumptions, risks, and uncertainties, many of which are outside of our control. Our actual results may differ materially from those set forth in our forward-looking statements. There is no assurance that any list of risks and uncertainties or risk factors is complete. Factors that could cause actual results to differ from those described in forward-looking statements, include, but are not limited to:

- deterioration of commercial real estate market fundamentals;
- defaults by our loan counterparties or trends;
- adverse changes in credit quality trends;
- declining asset prices;
- our ability to accurately estimate collateral values, future levels of nonperforming loans, and other borrower fundamentals as part of our credit review process;
- changes in local, regional and international business, economic or political conditions affecting the regions in which we operate;
- the extensive and increasing regulation of the U.S. financial services industry;
- changes in accounting policies, rules and interpretations;
- increasing capital and liquidity standards under applicable regulatory rules;
- unanticipated changes in our liquidity position, including but not limited to, changes in the cost of liquidity, our ability to enter the financial markets and to secure alternative funding sources;
- our ability to receive dividends from our subsidiary, The Union Bank Company;

- breaches of security or failures of our technology systems due to technological or other factors and cybersecurity threats;
- operational or risk management failures by us or critical third-parties;
- adverse judicial proceedings;
- the occurrence of natural or man-made disasters or conflicts or terrorist attacks;
- a reversal of the U.S. economic recovery due to financial, political or other shocks;
- our ability to anticipate interest rate changes and manage interest rate risk;
- deterioration of economic conditions in the geographic regions where we operate;
- the soundness of other financial institutions;
- our ability to attract and retain talented executives and employees and to manage our reputational risks;

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- our ability to timely and effectively implement our strategic initiatives; and
- increased competitive pressure due to industry consolidation.

Any forward-looking statements made by us or on our behalf speak only as of the date they are made, and we do not undertake any obligation to update any forward-looking statement to reflect the impact of subsequent events or circumstances. Before making an investment decision, you should carefully consider all risks and uncertainties disclosed in our SEC filings, including this report on Form 10-K and our subsequent reports on Form 10-Q and 8-K and any other filings made with the SEC, all of which are or will upon filing be accessible on the SEC's website at www.sec.gov and on our website at www.theubank.com.

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PART I

Item 1.
Business

Overview

United Bancshares, Inc. ("UBOH"), an Ohio corporation, organized in 1985, is headquartered in Columbus Grove, Ohio. We are a bank holding company under the Bank Holding Company Act of 1956, as amended (the "BHCA"), with consolidated total assets of $780.5 million at December 31, 2017. UBOH is regulated as a one-bank holding company by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), and its principal asset and operating subsidiary is The Union Bank Company, an Ohio state chartered commercial bank ("Union Bank"). As of December 31, 2017, UBOH and its subsidiary (collectively the "Corporation") employed approximately 177 full-time equivalent employees.

United Bancshares, Inc.'s common stock has traded on the NASDAQ Global Market under the symbol "UBOH" since March 2001.

Union Bank

Union Bank is an Ohio state-chartered bank supervised by the State of Ohio, Division of Financial Institutions (the "ODFI"), and the Federal Deposit Insurance Corporation (the "FDIC"). Through Union Bank, we provide a wide range of commercial and retail banking services. Union Bank offers a full range of commercial banking services, including checking accounts, savings and money market accounts; certificates of deposit; on-line banking and automatic teller machines; commercial, consumer, agricultural, residential mortgage and home equity loans; wealth management services; treasury management services; safe deposit box rentals; and other personalized banking services. Through our seventeen branch offices located in Bowling Green, Columbus Grove, Delaware, Delphos, Findlay, Gahanna, Gibsonburg, Kalida, Leipsic, Lima, Marion, Ottawa, Pemberville, and Westerville Ohio, we serve the Ohio counties of Allen, Delaware, Franklin, Hancock, Marion, Putnam, Sandusky, Van Wert, and Wood.

In the operation of its business, Union Bank maintains a strong community orientation. Union Bank's business model emphasizes personalized service, clients' access to key decision makers, individualized-attention, tailored products, and access to on-line banking tools. Union Bank's management has placed a special emphasis on personalized attention to its customers' needs in order to better serve the members of the community and create opportunities for them. Union Bank concentrates its efforts on serving the financial needs of the business in the Ohio counties that it serves as well as on providing financing to customers seeking to purchase or build their own homes; routinely seeking opportunities to foster economic growth and wealth accumulation in local economies through the financing of local entrepreneurs and residences in the areas we serve.

Union Bank has two subsidiaries: UBC Investments, Inc. ("UBC"), an entity formed to hold its securities portfolio, and UBC Property, Inc. ("UBC Property"), an entity formed to hold and manage certain property that is acquired in lieu of foreclosure.

Additional information

Our executive offices are located at 105 Progressive Drive, Columbus Grove, OH 45830 and our telephone number is (419) 659-2141. Our website is www.theubank.com.

We make available free of charge, on or through the Investor Relations link on our website (www.theubank.com), our annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Also posted on our website and available in print upon request are the charters for our Audit Committee, Compensation, and Nominating Committees and our Senior Officer Code of Ethics. Within the time period required by the SEC and the NASDAQ Global Market, we will post on our website any

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amendment to the Senior Officer Code of Ethics or the above-referenced governance documents or you may request the documents by writing to our Chief Financial Officer at The Union Bank Co., 105 Progressive Drive, Columbus Grove, OH 45830 or by calling (419) 659-2141.

The public may read and copy any filed materials with the SEC at the SEC's Public Reference Room at 100 E. Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Referenced Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements, and other information that the Corporation electronically files with the SEC.

Competition

The Corporation competes for deposits with other commercial banks, savings associations and credit unions and issuers of commercial paper and other securities, such as shares in money market mutual funds. Primary factors in competing for deposits include customer service, interest rates and convenience. In making loans, the Corporation competes with other commercial banks, savings associations, consumer finance companies, credit unions, leasing companies, mortgage companies and other lenders. Competition is affected by, among other things, the general availability of lendable funds, general and local economic conditions, current interest rate levels and other factors that are not readily predictable. The financial services industry is likely to become more competitive as further technology advances enable more companies to provide financial services. We compete by offering quality products and innovative services at competitive prices, and by maintaining our products and services offerings to keep pace with customer preferences in the regions that we operate.

In recent years, mergers and acquisitions have led to greater concentration in the banking industry, placing added competitive pressure on our core banking products and services. Consolidation continued during 2017, primarily through private merger and acquisition transactions, and led to redistribution of deposits and certain banking assets to other financial institutions. We expect this trend to continue during 2018. We, therefore, expect competition in the markets we serve to intensify with the advent of new technology and consolidation trends. As a matter of course, we continue to evaluate opportunities in the markets we serve or contiguous markets to improve our footprint, while balancing the efficiency of technology.

Supervision and Regulation

General

The following discussion addresses the material elements of the regulatory framework applicable to bank holding companies, like UBOH, and our subsidiary bank, Union Bank. This regulatory framework is intended primarily to protect customers and depositors, the Deposit Insurance Fund (the "DIF") of the FDIC, and the banking system as a whole, rather than for the protection of security holders and creditors. We cannot predict changes in the applicable laws, regulations and regulatory agency policies, yet such changes may have a material effect on our business, financial condition or results of operations.

UBOH

As a bank holding company, UBOH is subject to the regulation, supervision, and examination by the Federal Reserve Board under the BHCA. Pursuant to the BHCA, bank holding companies generally may not, in general, directly or indirectly own or control more than 5% of the voting shares, or substantially all of the assets, of any bank or savings association, without prior approval by the Federal Reserve Board. In addition, bank holding companies are generally prohibited from engaging in commercial or industrial activities.

Under federal law, a bank holding company, like UBOH, must serve as a source of financial strength to its subsidiary depository institutions by providing financial assistance to them in the event of their financial distress. This support may be required when we do not have the resources to, or would prefer not to, provide it. Certain loans by a bank holding company to a subsidiary bank are subordinate in right of payment to deposits in, and certain other indebtedness of, the subsidiary bank. In addition, federal law

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provides that in the bankruptcy of a bank holding company, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Union Bank

As an Ohio state-chartered bank, and a member of the DIF, administered by the FDIC, Union Bank is supervised and regulated by the ODFI and the FDIC. As insurer, the FDIC imposes deposit insurance premiums and conducts examinations of and requires reporting by FDIC-insured institutions under the Federal Deposit Insurance Act, as amended (the "FDIA").

Various requirements and restrictions under the laws of the United States and the State of Ohio affect the operations of Union Bank, including requirements to maintain reserves against deposits, restrictions on the nature and amount of loans which may be made and the interest that may be charged thereon, restrictions relating to investments and other activities, limitations on credit exposure to correspondent banks, limitations on activities based on capital and surplus, limitations on payment of dividends, and limitations on branching.

As a member of the Federal Home Loan Bank, Union Bank is required to, among other things, maintain an investment in capital stock of the FHLB. Union Bank receives dividends on its investment in FHLB stock. Under certain conditions, secured advances to Union Bank are available from the FHLB to meet operational requirements. Such advances are renewable and can be obtained up to specified dollar amounts. These advances are secured primarily by Union Bank's eligible mortgage loans and FHLB stock.

Regulatory capital and liquidity

Current regulatory capital requirements

Federal banking regulators have promulgated risk-based capital and leverage ratio requirements applicable to UBOH and Union Bank. The adequacy of regulatory capital is assessed periodically by federal banking agencies in their examination and supervision processes, and in the evaluation of applications in connection with certain expansion activities.

The risk-based capital guidelines adopted by the federal banking regulators and effective through December 31, 2017, include both a definition and a framework for calculating risk weighted assets by assigning assets and off-balance sheet items to broad risk categories. The minimum ratio of total capital to risk weighted assets (including certain off-balance sheet items, such as standby letters of credit) is 8%. At least 4% is to be comprised of common shareholders' equity (including retained earnings but excluding treasury stock), noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock, and minority interest in equity accounts of consolidated subsidiaries, less goodwill and certain other intangible assets ("Tier 1 capital"). The remainder ("Tier 2 capital") may consist, among other things, of mandatory convertible debt securities, a limited amount of subordinated debt, other preferred stock and a limited amount of allowance for loan losses. Each of the federal banking agencies also impose a minimum leverage ratio (Tier 1 capital to total assets) for banking organizations. The minimum leverage ratio is currently 3% for bank holding companies that are considered "strong" under the Federal Reserve Board's guidelines or which have implemented the Federal Reserve Board's risk-based capital measure for market risk. The minimum leverage ratio is 1%-2% higher for other bank holding companies and banks based on their particular circumstances and risk profiles and for those banks experiencing or anticipating significant growth. The FDIC imposes similar capital requirements on Union Bank adopted by the FDIC.

The Corporation currently satisfies all capital requirements. Failure to meet applicable capital guidelines could subject a banking institution to a variety of enforcement remedies available to federal and state regulatory authorities, including the termination of deposit insurance by the FDIC. The junior subordinated deferrable interest debentures issued in 2003 and the trust preferred securities from the acquisition of The Ohio State Bank ("OSB"), as described in Note 10 of the consolidated financial statements contained in the Corporation's Annual Report, currently qualify as Tier 1 capital for regulatory purposes. However, it is possible that regulations could change so that such securities do not qualify.

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The federal banking regulators have established regulations governing prompt corrective action to resolve capital deficient banks. Under these regulations, institutions, which become undercapitalized, become subject to mandatory regulatory scrutiny and limitations that increase as capital decreases. Such institutions are also required to file capital plans with their primary federal regulator, and their holding companies must guarantee the capital shortfall up to 5% of the assets of the capital deficient institution at the time it becomes undercapitalized.

The ability of a bank holding company to obtain funds for the payment of dividends and for other cash requirements is largely dependent on the amount of dividends that may be declared by its subsidiary bank and other subsidiaries. However, the Federal Reserve Board expects the Corporation to serve as a source of strength to its subsidiary bank, which may require it to retain capital for further investment in the subsidiary, rather than for dividends for shareholders of UBOH. The Bank may not pay dividends to UBOH if, after paying such dividends, it would fail to meet the required minimum levels under the risk-based capital guidelines and the minimum leverage ratio requirements. The Bank must have the approval of its regulatory authorities if a dividend in any year would cause the total dividends for that year to exceed the sum of the current year's net income and the retained net income for the preceding two years, less required transfers to surplus. Payment of dividends by a bank subsidiary may be restricted at any time at the discretion of the regulatory authorities, if they deem such dividends to constitute an unsafe and/or unsound banking practice. These provisions could have the effect of limiting UBOH's ability to pay dividends on its outstanding common shares.

The FDIA requires the relevant federal banking regulator to take "prompt corrective action" with respect to an FDIC-insured depository institution that does not meet certain capital adequacy standards. Banks and savings associations are classified into one (1) of five (5) categories based upon capital adequacy, ranging from "well-capitalized" to "critically undercapitalized." Restrictions on operations, management and capital distributions begin to apply at "adequately capitalized" status and become progressively stricter as the insured depository institutions approaches "critically undercapitalized" status. Generally, the regulations require the appropriate federal banking agency to take prompt corrective action with respect to an institution which becomes "undercapitalized" and to take additional actions if the institution becomes "significantly undercapitalized" or "critically undercapitalized." Effective January 1, 2015, final rules promulgated by the FDIC pursuant to the Dodd-Frank Act, provide that for a depository institution to be considered well-capitalized it must maintain common equity tier 1 capital of at least 6.5%; tier 1 risk-based capital of at least 8%; total risk-based capital of at least 10%; and a tier 1 leverage ratio of at least 5%. As of December 31, 2017, Union Bank has total risk-based capital of 11.2%, tier 1 risk-based capital and CET 1 capital of 10.7%, and tier 1 leverage of 8.5%. While the Prompt Corrective Action requirements only apply to FDIC-insured depository institutions and not to bank holding companies, the mandatory Prompt Corrective Action "capital restoration plan" required of an undercapitalized institution by its relevant regulator must be guaranteed to a limited extent by the institution's parent bank holding company.

In October 2013, the federal banking regulators published final rules establishing a new comprehensive capital framework for U.S. banking organizations (the "Regulatory Capital Rules"). The Regulatory Capital Rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standard as well as certain provisions of the Dodd-Frank Act. The implementation of the Regulatory Capital Rules will lead to higher capital requirements and more restrictive leverage liquidity ratios than those currently in place. In addition, in order to avoid limitations on capital distributions, such as dividend payments and certain bonus payments to executive officers, the Regulatory Capital Rules require insured financial institutions to hold a capital conservation buffer of common equity tier 1 capital above the minimum risk-based capital requirements. The capital conservation buffer will be phased in over time becoming fully effective on January 1, 2019, and will consist of an additional amount of common equity equal to 2.5% of risk-weighted assets. The Regulatory Capital Rules also revise the regulatory agencies' prompt corrective action framework by incorporating the new regulatory capital minimums and updating the definition of common equity. The Regulatory Capital Rules phase in began on January 1, 2015, for non-advanced approaches banking organizations, like UBOH and Union Bank and will be fully phased in by January 1, 2019. While UBOH and Union Bank currently meet all regulatory capital requirements, the ultimate impact upon the financial condition or results of operations cannot be predicted until 2019 when the rules become fully-phased in.

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Federal banking law and regulations impose limitations on the payment of dividends by our bank subsidiary, Union Bank. Historically, dividends paid by Union Bank have been an important source of cash flow for UBOH to pay dividends on its equity securities and interest on its debt. Dividends by our bank subsidiary are limited to the lessor of the amounts calculated under an earnings retention test and an undivided profits test. Under the earnings retention test, without the prior approval of the FDIC, a dividend may not be paid if the total of all dividends declared by a bank in any calendar year is in excess of the current year's net income combined with the retained net income of the two preceding years. Under the undivided profits test, a dividend may not be paid in excess of a bank's undivided profits. Moreover, under the FDIA, an insured depository institution may not pay a dividend if the payment would cause it to be in a less than "adequately capitalized" prompt corrective action capital category or if the institution is in default in the payment of an assessment due to the FDIC. For more information about the payment of dividends by Union Bank to UBOH, please see Note 15 of the consolidated financial statements contained in the Corporation's Annual Report.

FDIA and Resolution Authority

Federal Deposit Insurance Act

The FDIC's DIF provides insurance coverage for certain deposits, which insurance is funded through assessments on banks, like Union Bank. Pursuant to the Dodd-Frank Act, the amount of deposit insurance coverage for deposits increased to $250,000 per depositor. Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection act (the "Dodd-Frank Act"), the FDIC has established 2.0% as the designated reserve ratio (the "DRR"), that is, the ratio of the DIF to insured deposits. The Dodd-Frank Act directs the FDIC to amend its assessment regulations so that future assessments will generally be based upon a depository institution's average total consolidated assets minus the average tangible equity of the insured depository institution during the assessment period, whereas assessments were previously based on the amount of an institution's insured deposits. The minimum DIF rate will increase from 1.15% to 1.35% by September 30, 2020, and the cost of the increase will be borne by depository institutions with assets of $10 billion or more. At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required.

Conservatorship and receivership of insured depository institutions

Upon the insolvency of an insured depository institution, the FDIC will be appointed as receiver or, in rare circumstances, conservator for the insolvent institution under the FDIA. In an insolvency, the FDIC may repudiate or disaffirm any contract to which the institution is a party if the FDIC determines that performance of the contract would be burdensome and that disaffirming or repudiating the contract would promote orderly administration of the institution's affairs. If the contractual counterparty made a claim against the receivership (or conservatorship) for breach of contract, the amount paid to the counterparty would depend upon, among other factors, the receivership assets available to pay the claim and the priority of the claim relative to others. In addition, the FDIC may enforce most contracts entered into by the insolvent institution, notwithstanding any provision that would terminate, cause a default, accelerate or give other rights under the contract solely because of the insolvency, the appointment of the receiver (or conservator), or the exercise of rights or powers by the receiver (or conservator). The FDIC may also transfer any asset or liability of the insolvent institution without obtaining approval or consent from the institution's shareholders or creditors. These provisions would apply to obligations and liabilities of UBOH's insured depository institution subsidiary, including any obligations under senior or subordinated debt issued to public investors.

Depositor preference

The FDIA provides that, in the event of the liquidation or other resolution of an insured depository institution, the claims of its depositors (including claims of its depositors that have subrogated to the FDIC) and certain claims for administrative expenses of the FDIC as receiver have priority over other general unsecured claims. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will be placed ahead of unsecured, non-deposit creditors, including the institution's parent bank, holding company and subordinated creditors, in order of priority of payment.

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Other Regulatory Developments under the Dodd-Frank Act

Federal regulators continue to implement provisions of the Dodd-Frank Act. The Dodd-Frank Act created many new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions. Currently, federal regulators are still in the process of drafting the implementing regulations for some portions of the Dodd-Frank Act. The Corporation is closely monitoring all relevant sections of the Dodd-Frank Act to ensure continued compliance with these regulatory requirements. The following discussion summarizes significant aspects of the Dodd-Frank Act that are already affecting or may affect UBOH and Union Bank:

- the Consumer Financial Protection Bureau has been empowered to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws;

- the deposit insurance assessment base for federal deposit insurance has been expanded from domestic deposits to average assets minus average tangible equity;

- the prohibition on the payment of interest on commercial demand deposits has been repealed;

- the standard maximum amount of deposit insurance per customer has been permanently increased to $250,000;

- new corporate governance requirements require new compensation practices, including, but not limited to, providing shareholders the opportunity to cast a non-binding vote on executive compensation, requiring compensation committees to consider the independence of compensation advisors and meeting new executive compensation disclosure requirements;

- the Federal Reserve Board has established rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion. Although the cap is not applicable to Union Bank, it may have an adverse effect on Union Bank as the debit cards issued by Union Bank and other smaller banks, which have higher interchange fees, may become less competitive;

- “ability to repay” regulations generally require creditors to make a reasonable, good faith determination (considering at least 8 specified underwriting factors) of a consumer’s ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage or temporary loan) and provides a presumption that the creditor making a “qualified mortgage” satisfied the ability-to-repay requirements; and

- the authority of the Federal Reserve Board to examine financial holding companies and their non-bank subsidiaries was expanded.

Some aspects of the Dodd-Frank Act are still subject to rulemaking and will take effect in the coming years, making it difficult to anticipate the full financial impact on the Corporation, their respective customers or the financial services industry more generally. However, the implementation of certain provisions have already increased compliance costs and the implementation of future provisions will most likely further increase both compliance costs and fees paid to regulators, along with possibly restricting the operations of the Corporation.

The Bank Secrecy Act (BSA)

The BSA requires all financial institutions (including banks and securities broker-dealers) to, among other things, maintain a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. It includes a variety of recordkeeping and reporting requirements (such as cash and suspicious activity reporting) as well as due diligence and know-your-customer documentation requirements. Union Bank has established and maintains an anti-money laundering program to comply with the BSA's requirements.

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Bank transactions with affiliates

Federal banking law and regulation imposes qualitative standards and quantitative limitations upon certain transactions by a bank with its affiliates, including the bank's parent bank holding company and certain companies the parent bank holding company may be deemed to control for these purposes. Transactions covered by these provisions must be on arm's-length terms, and cannot exceed certain amounts which are determined with reference to the bank's regulatory capital. Moreover, if the transaction is a loan or other extension of credit, it must be secured by collateral in an amount and quality expressly prescribed by statute, and if the affiliate is unable to pledge sufficient collateral, the bank holding company may be required to provide it.

Statistical Financial Information Regarding the Corporation

The following schedules and table analyze certain elements of the consolidated balance sheets and statements of income of the Corporation and its subsidiary, as required under Securities Act Industry Guide 3 promulgated by the Securities and Exchange Commission, and should be read in conjunction with the narrative analysis presented in ITEM 7, MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION and the Consolidated Financial Statements of the Corporation, both of which are included in the 2017 Annual Report.

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I.
DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL

A.
The following are the average balance sheets for the years ended December 31:

	2017	2016	2015
	(in thousands)		
ASSETS			
Interest-earning assets			
Securities(1)			
Taxable	$ 118,335	$ 121,442	$ 139,407
Non-taxable	71,480	70,371	68,331
Interest-bearing deposits	6,999	11,042	11,336
Loans(2)	421,564	361,437	358,368
Total interest-earning assets	618,378	564,292	577,442
Non-interest-earning assets			
Cash and due from banks	9,155	9,081	8,932
Premises and equipment, net	16,504	11,929	12,211
Accrued interest receivable and other assets	42,160	32,984	33,754
Allowance for loan losses	(3,033)	(3,598)	(3,586)
	$ 683,164	$ 614,688	$ 628,753
LIABILITIES AND SHAREHOLDERS' EQUITY			
Interest-bearing liabilities			
Deposits			
Savings and interest-bearing demand deposits	$ 323,805	$ 285,729	$ 283,904
Time deposits	141,757	140,562	159,635
Junior subordinated deferrable interest debentures	12,825	12,791	12,755
Other borrowings	23,090	4,525	9,739
Total interest-bearing liabilities	501,477	443,607	466,033
Non-interest-bearing liabilities			
Demand deposits	100,148	92,811	87,820
Accrued interest payable and other liabilities	5,942	4,203	4,919
Shareholders' equity(3)	75,597	74,067	69,981
	$ 683,164	$ 614,688	$ 628,753

(1)
Securities include securities available-for-sale, which are carried at fair value, and restricted bank stock carried at cost. The average balance includes monthly average balances of fair value adjustments and daily average balances for the amortized cost of securities.

(2)
Loan balances include principal balances of non-accrual loans and loans held for sale.

(3)
Shareholders' equity includes average net unrealized appreciation (depreciation) on securities available-for-sale, net of tax.

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I.
DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL (CONTINUED)

B.
The following tables set forth, for the years indicated, the condensed average balances of interest-earning assets and interest-bearing liabilities, the interest earned or paid on such amounts, and the average interest rates earned or paid thereon.

	2017 Average Balance	Interest	Average Rate
	(dollars in thousands)		
Interest-earning assets			
Securities(1)			
Taxable	$ 118,335	$ 2,403	2.03%
Non-taxable(2)	71,480	2,549	3.57%
Loans(3),(4)	421,564	21,305	5.05%
Interest-bearing deposits	6,999	382	5.46%
Total interest-earning assets	618,378	26,639	4.31%
INTEREST-BEARING LIABILITIES			
Deposits			
Savings and interest-bearing demand deposits	$ 323,805	888	0.27%
Time deposits	141,757	1,237	0.87%
Junior subordinated deferrable interest debentures	12,825	596	4.65%
Other borrowings	23,090	397	1.72%
Total interest-bearing liabilities	$ 501,477	3,118	0.62%
Net interest income, tax equivalent basis		$ 23,521	
Net interest income as a percent of average interest-earning assets			3.80%

(1)
Securities include securities available-for-sale, which are carried at fair value, and restricted bank stock carried at cost. The average balance includes monthly average balances of fair value adjustments and daily average balances for the amortized cost of securities.

(2)
Computed on tax equivalent basis for non-taxable securities (34% statutory rate).

(3)
Loan balances include principal balance of non-accrual loans and loans held for sale.

(4)
Interest income on loans includes fees of $1,137,000.

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I.
DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL (CONTINUED)

	2016 Average Balance	Interest	Average Rate
	(dollars in thousands)		
Interest-earning assets			
Securities(1)			
Taxable	$ 121,442	$ 2,202	1.81%
Non-taxable(2)	70,371	2,479	3.52%
Loans(3),(4)	361,437	17,457	4.83%
Interest-Bearing Deposits	11,042	332	3.01%
Total interest-earning assets	564,292	22,470	3.98%
INTEREST-BEARING LIABILITIES			
Deposits			
Savings and interest-bearing demand deposits	$ 285,729	578	0.20%
Time deposits	140,562	1,109	0.79%
Junior subordinated deferrable interest debentures	12,791	495	3.87%
Other borrowings	4,525	49	1.08%
Total interest-bearing liabilities	$ 443,607	2,231	0.50%
Net interest income, tax equivalent basis		$ 20,239	
Net interest income as a percent of average interest-earning assets			3.59%

(1)
Securities include securities available-for-sale, which are carried at fair value, and FHLB stock carried at cost. The average balance includes monthly average balances of market value adjustments and daily average balances for the amortized cost of securities.

(2)
Computed on tax equivalent basis for non-taxable securities (34% statutory rate).

(3)
Loan balances include principal balance of non-accrual loans and loans held for sale.

(4)
Interest income on loans includes fees of $971,000.

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I.
DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL (CONTINUED)

	2015 Average Balance	Interest	Average Rate
	(dollars in thousands)		
Interest-earning assets			
Securities(1)			
Taxable	$ 139,407	$ 2,549	1.83%
Non-taxable(2)	68,331	2,555	3.74%
Loans(3),(4)	358,368	18,322	5.11%
Interest-Bearing Deposits	11,336	279	2.46%
Total interest-earning assets	577,442	23,705	4.11%
INTEREST-BEARING LIABILITIES			
Deposits			
Savings and interest-bearing demand deposits	$ 283,904	335	0.12%
Time deposits	159,635	1,245	0.78%
Junior subordinated deferrable interest debentures	12,755	446	3.50%
Other borrowings	9,739	52	0.53%
Total interest-bearing liabilities	$ 466,033	2,078	0.45%
Net interest income, tax equivalent basis		$ 21,627	
Net interest income as a percent of average interest-earning assets			3.75%

(1)
Securities include securities available-for-sale, which are carried at fair value, and FHLB stock carried at cost. The average balance includes monthly average balances of market value adjustments and daily average balances for the amortized cost of securities.

(2)
Computed on tax equivalent basis for non-taxable securities (34% statutory rate).

(3)
Loan balances include principal balance of non-accrual loans and loans held for sale.

(4)
Interest income on loans includes fees of $706,000.

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I.
DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL (CONTINUED)

C.
The following tables set forth the effect of volume and rate changes on interest income and expenses for the periods indicated. For purposes of these tables, changes in interest due to volume and rate were determined as follows:

Volume variance — change in volume multiplied by the previous year's rate.
Rate variance — change in rate multiplied by the previous year's volume.
Rate/volume variance — change in volume multiplied by the change in rate.
•
This variance was allocated to volume variances and rate variances in proportion to the relationship of the absolute dollar amount of the change in each.

Interest on non-taxable securities has been adjusted to a fully tax equivalent basis using a statutory tax rate of 34% in all years presented.

	2017/2016		
	Total Variance	Variance Attributable To	
		Volume	Rate
	(in thousands)		
INTEREST INCOME			
Securities –			
Taxable	$ 201	$ (57)	$ 258
Non-taxable	70	39	31
Loans	3,848	3,009	839
Other	50	(152)	