

COMMUNITY BANK SYSTEM, INC.
Form 424B3
February 10, 2017

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Registration No. 333-214961**

PROPOSED MERGER YOUR VOTE IS VERY IMPORTANT

Dear Stockholder:

On October 22, 2016, the board of directors of Merchants Bancshares, Inc. (Merchants) unanimously approved an Agreement and Plan of Merger (the Merger Agreement) between Merchants and Community Bank System, Inc. (Community Bank System). Merchants is holding a special meeting of stockholders on Thursday, March 23, 2017, at 10:00 a.m., Eastern time, at the DoubleTree by Hilton, 1117 Williston Road, South Burlington, Vermont 05403, for its stockholders of record on February 2, 2017, to vote on the proposals necessary to complete the merger. If Merchants stockholders adopt the Merger Agreement and the merger is subsequently completed, Merchants will merge with and into Community Bank System (the Merger), with Community Bank System continuing as the surviving company.

If the Merger Agreement proposal is approved and the Merger is subsequently completed, Merchants stockholders may elect to receive, in exchange for each outstanding share of Merchants common stock they hold, either: (i) \$40.00 in cash (which we refer to as the cash election consideration); (ii) 0.9630 shares of common stock of Community Bank System (which we refer to as the stock election consideration); or (iii) a combination of \$12.00 in cash and 0.6741 shares of common stock of Community Bank System (which we refer to as the mixed election consideration).

Both the cash election consideration and the stock election consideration are subject to proration and adjustment procedures to ensure that the total amount of cash paid, and the total number of shares of Community Bank System common stock issued, in the Merger to Merchants stockholders, as a whole, will equal as nearly as practicable the total amount of cash and number of shares that would have been paid and issued if all of the Merchants stockholders received the mixed election consideration. Merchants stockholders who fail to make a timely election or who make no election will receive the mixed election consideration. For more information, see Proposal I The Merger and The Merger Agreement.

The precise consideration that Merchants stockholders will receive if they elect the cash election consideration or the stock election consideration will not be known at the time that Merchants stockholders vote on the proposal to adopt the Merger Agreement or make an election as to the type of consideration that they would like to receive in the Merger. On October 21, 2016, which was the last trading date on the New York Stock Exchange (NYSE) preceding the public announcement of the Merger, the closing price of Community Bank System common stock was \$47.50 per share, valuing the mixed election consideration at approximately \$44.02 per share. On February 2, 2017, the most recent practicable date prior to the mailing of this Proxy Statement/Prospectus, the closing price of Community Bank System common stock on the NYSE was \$57.67, valuing the mixed election consideration at approximately \$50.88 per share. Based on 6,898,903 shares of Merchants common stock issued and outstanding, Community Bank System expects to issue in the Merger approximately 4,650,551 shares of its common stock before taking into account any adjustment for the issuance of cash in lieu of fractional shares.

The market prices of Community Bank System common stock and Merchants common stock will fluctuate before the completion of the Merger. **You should obtain current stock price quotations for Community Bank System and Merchants common stock before you vote.** Community Bank System common stock is listed on the NYSE under the symbol CBU. Merchants common stock is traded on the NASDAQ Global Select Market (NASDAQ) under the

symbol MBVT.

Under the terms of the Merger Agreement, in the event that the volume-weighted average trading price of Community Bank System common stock for a specified period prior to the closing is less than \$35.77 per share and the decrease in the price of Community Bank System's common stock is more than 20% greater than the decrease in the SNL Midcap U.S. Bank Index over the same period, Merchants has the right to terminate the Merger Agreement, Community Bank System has the option to increase the amount of Community Bank System common stock issuable to Merchants stockholders by a formula-based amount set forth in the Merger Agreement to prevent such termination.

The Merchants board of directors has unanimously determined that the Merger and the Merger Agreement are advisable and in the best interests of Merchants and its stockholders and unanimously recommends that you vote FOR the adoption of the Merger Agreement, FOR approval, on an advisory basis, of the Merger-related executive compensation payable to the Merchants named executive officers in connection with the Merger, and FOR the proposal to adjourn the Merchants special meeting, if necessary or appropriate, to solicit additional proxies in favor of the proposal to adopt the Merger Agreement.

The Merger cannot be completed unless at least two-thirds of the issued and outstanding shares of Merchants common stock entitled to vote at the special meeting vote in favor of the Merger. Whether or not you plan to attend the special meeting of stockholders, please take the time to vote by using the Internet, by telephone or by completing the enclosed proxy card and mailing it in the enclosed envelope. If you sign, date and mail your proxy card without indicating how you want to vote, your proxy will be counted as a vote FOR each of the proposals being voted on at Merchants' special meeting. If you fail to vote, or you do not instruct your broker how to vote any shares held for you in street name, it will have same effect as voting AGAINST the Merger Agreement, but it will have no impact on the advisory, non-binding proposal to approve the Merger-related executive compensation or the proposal to approve an adjournment of the special meeting.

The accompanying document is being delivered to Merchants stockholders as Community Bank System's Prospectus for its offering of Community Bank System common stock in connection with the Merger, and as Merchants' Proxy Statement for the solicitation of proxies for the special meeting.

This Proxy Statement/Prospectus provides you with detailed information about the proposed Merger. It also contains or references information about Merchants, Community Bank System and related matters. You are encouraged to read this document carefully. **In particular, you should read the Risk Factors section beginning on page 15 of this Proxy Statement/Prospectus for a discussion of the risks you should consider in evaluating the proposed Merger and how it will affect you.**

On behalf of our board of directors, I thank you for your prompt attention to this matter.

Sincerely,

Jeffrey L. Davis
Chairman of the Board of Directors

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the Merger, the issuance of the Community Bank System common stock in connection with the Merger or the other transactions described in this Proxy Statement/Prospectus, or passed upon the adequacy or accuracy of the disclosure in this document. Any representation to the contrary is a criminal offense.

The securities to be issued in connection with the Merger are not savings accounts, deposits or other obligations of any bank or savings association and are not insured by the Federal Deposit Insurance Corporation or any

other governmental agency.

This Proxy Statement/Prospectus is dated February 7, 2017, and is first being mailed to stockholders of Merchants on or about February 10, 2017.

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MERCHANTS BANCSHARES, INC.
275 Kennedy Drive
South Burlington, Vermont 05403

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS TO BE HELD ON MARCH 23, 2017

NOTICE IS HEREBY GIVEN that a special meeting of the stockholders of Merchants Bancshares, Inc. (Merchants) will be held on Thursday, March 23, 2017, at 10:00 a.m., Eastern time, at the DoubleTree by Hilton, 1117 Williston Road, South Burlington, Vermont 05403, to consider and vote upon the following matters:

1. a proposal to adopt the Agreement and Plan of Merger, dated as of October 22, 2016, by and between Community Bank System, Inc. (Community Bank System) and Merchants (the Merger Agreement), which provides for the merger of Merchants with and into Community Bank System with Community Bank System as the surviving company (the Merger);
2. a non-binding, advisory proposal to approve the compensation payable to the named executive officers of Merchants in connection with the Merger (the Merger-Related Executive Compensation);
3. a proposal to approve one or more adjournments of the special meeting, if necessary or appropriate, to solicit additional proxies if there are insufficient votes at the time of the special meeting to adopt the Merger Agreement (the adjournment proposal); and
4. any other business which may properly come before the special meeting or any adjournment thereof.

The Merger is described in more detail in this Proxy Statement/Prospectus, which you should read carefully in its entirety before you vote. A copy of the Merger Agreement is attached as **Annex A** to this Proxy Statement/Prospectus. Only holders of record of Merchants common stock at the close of business on February 2, 2017 are entitled to notice of and to vote at the special meeting and any adjournments or postponements of the special meeting.

Under Delaware law, Merchants stockholders who do not vote in favor of adoption of the Merger Agreement will have the right to seek appraisal of the fair value of their Merchants common stock as determined by the Delaware Court of Chancery if the Merger is completed, but only if they submit a written demand for such an appraisal prior to the vote on adoption of the Merger Agreement and strictly comply with the other Delaware law procedures explained in this Proxy Statement/Prospectus. See the section entitled Proposal I The Merger Appraisal or Dissenters Rights beginning on page 58. The applicable Delaware law is reproduced in its entirety in Annex C to this Proxy Statement/Prospectus.

Please vote as soon as possible. The affirmative vote of two-thirds of the outstanding shares of Merchants common stock entitled to vote at the special meeting of stockholders is required for the adoption of the Merger Agreement. Approval of the non-binding, advisory Merger-Related Executive Compensation proposal requires the affirmative vote of a majority of the votes cast on the proposal. Approval of the adjournment proposal requires the affirmative vote of a majority of the votes cast on the proposal.

If you fail to vote, or you do not instruct your broker how to vote any shares held for you in street name, it will have same effect as voting AGAINST the Merger Agreement.

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To ensure your representation at the special meeting of stockholders, please follow the voting procedures described in the accompanying Proxy Statement/Prospectus and on the enclosed proxy card. This will not prevent you from voting in person, but it will help to secure a quorum and avoid added solicitation costs. Your proxy may be revoked at any time before it is voted by following the instructions provided in the Proxy Statement/Prospectus.

THE MERCHANTS BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR ALL PROPOSALS.

BY ORDER OF THE BOARD OF DIRECTORS

Jamie Oberle
Secretary

South Burlington, Vermont
February 7, 2017

YOUR VOTE IS IMPORTANT!

Whether or not you plan to attend the special meeting in person, Merchants urges you to submit your proxy as soon as possible by (1) calling the toll free telephone number specified on the enclosed proxy card, (2) accessing the Internet website specified on the enclosed proxy card, or (3) completing, signing and dating the enclosed proxy card and returning it in the postage paid envelope provided. If your shares are held in the name of a bank, broker or other fiduciary, please follow the instructions on the voting card provided by such entity.

If you have any questions concerning the Merger or other matters to be considered at the Merchants special meeting, would like additional copies of this Proxy Statement/Prospectus or need help voting your shares, please contact Innisfree M&A Incorporated, Merchants proxy solicitor, by calling (212) 750-5833.

PLEASE DO NOT SEND STOCK CERTIFICATES WITH THE PROXY CARD. YOU WILL BE SENT SEPARATE INSTRUCTIONS REGARDING MAKING ELECTIONS AS TO THE FORM OF MERGER CONSIDERATION YOU WOULD LIKE TO RECEIVE AND THE SURRENDER OF YOUR STOCK CERTIFICATES.

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QUESTIONS AND ANSWERS ABOUT THE MERGER

The following are answers to certain questions that you may have regarding the merger and the special meeting. We urge you to read carefully the remainder of this Proxy Statement/Prospectus because the information in this section may not provide all the information that might be important to you in determining how to vote. Additional important information is also contained in the annexes to, and the documents incorporated by reference in, this Proxy Statement/Prospectus.

Q: Why am I receiving this document?

Community Bank System, Inc. (Community Bank System) and Merchants Bancshares, Inc. (Merchants) have agreed to combine under the terms of an Agreement and Plan of Merger by and between Community Bank System and Merchants, dated as of October 22, 2016 (the Merger Agreement), that is described in this Proxy Statement/Prospectus. A copy of the Merger Agreement is attached to this Proxy Statement/Prospectus as **Annex A**. In order to complete the merger of Merchants with and into Community Bank System (the Merger), the stockholders of Merchants must vote to adopt the Merger Agreement. Merchants will hold a special meeting of its stockholders to solicit this approval, as well as the non-binding advisory approval of the Merger-Related Executive Compensation and, if necessary, the approval of the adjournment proposal. We are delivering this Proxy Statement/Prospectus to you as both a Proxy Statement of Merchants and a Prospectus of Community Bank System. It is a Proxy Statement because the Merchants board of directors is soliciting proxies from its stockholders. It is a Prospectus because Community Bank System will issue Community Bank System common stock to the Merchants stockholders who receive stock consideration in the Merger, and this Prospectus contains information about Community Bank System common stock. This Proxy Statement/Prospectus contains important information about the Merger, the Merger Agreement, the special meeting of Merchants stockholders, and other related matters, and we encourage you to read it carefully.

Q: What will happen to Merchants as a result of the Merger?

If the Merger is completed, Merchants will cease to exist and Merchants Bank, the wholly-owned subsidiary of Merchants, will become a direct, wholly-owned subsidiary of Community Bank System. Immediately following completion of the Merger, Merchants Bank will then merge with and into Community Bank, N.A. (Community Bank), the wholly-owned subsidiary of Community Bank System, with Community Bank being the surviving bank.

Q: Who is being asked to approve matters in connection with the Merger?

Only Merchants stockholders are being asked to vote to approve the Merger-related proposals. Community Bank System is not required to obtain Community Bank System stockholder approval of the Merger or the Merger Agreement.

Q: What will I receive in the Merger?

If the Merger Agreement proposal is approved and the Merger is subsequently completed, each outstanding share of Merchants common stock will be converted into the right to receive either:

\$40.00 in cash, without interest (the cash election consideration);
0.9630 shares of Community Bank System common stock, plus cash in lieu of fractional shares (the stock election consideration); or
a combination of both \$12.00 in cash and 0.6741 shares of Community Bank System common stock, plus cash in lieu of fractional shares (the mixed election consideration).

The above consideration is subject to proration procedures that are designed to ensure that the total amount of cash paid, and the total number of shares of Community Bank System common stock issued, in the Merger will equal as nearly as practicable the total amount of cash and number of shares that would have been paid and issued if all of the Merchants stockholders received the mixed election consideration.

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You may elect to receive the cash election consideration, the stock election consideration, or the mixed election consideration. However, the ability to receive the consideration of your choice will depend on the elections of other Merchants stockholders. The proration of the consideration payable to Merchants stockholders in the Merger will not be known until Community Bank System tallies the results of the elections made by Merchants stockholders, which will not occur until near or after the closing of the Merger.

Q: Will I receive the form of consideration that I elect?

A: If you elect to receive the mixed election consideration, you will receive the mixed election consideration. If you elect to receive the cash election consideration or stock election consideration, you may not receive the exact form of consideration that you elect. If you make no election with respect to your shares of Merchants common stock (and do not exercise appraisal rights), you will receive the mixed election consideration.

It is currently estimated that, if the Merger is completed, Community Bank System will issue, in the aggregate, approximately 4.65 million shares of Community Bank System common stock and pay approximately \$82.78 million in cash to Merchants stockholders. Under the proration procedures in the Merger Agreement, the total amount of cash paid, and the total number of shares of Community Bank System common stock issued, in the Merger to the holders of shares of Merchants common stock (other than excluded shares), as a whole, will equal as nearly as practicable the total amount of cash and number of shares that would have been paid and issued if all of such shares of Merchants common stock were converted into the mixed election consideration.

Whether you receive the amount of cash and/or stock you request in your election form will depend in part on the elections of other Merchants stockholders. You may not receive the form of consideration that you elect in the Merger, and you may instead receive a pro-rata amount of cash and/or Community Bank System common stock.

The greater the oversubscription of the stock election consideration, the less stock and more cash a Merchants stockholder making the stock election will receive. Reciprocally, the greater the oversubscription of the cash election consideration, the less cash and more stock a Merchants stockholder making the cash election will receive. However, in no event will a Merchants stockholder who makes the cash election or the stock election receive less cash and more shares of Community Bank System common stock, or fewer shares of Community Bank System common stock and more cash, respectively, than a stockholder who elects the mixed election consideration. See The Merger Agreement Election and Proration Procedures beginning on page 63 of this Proxy Statement/Prospectus.

The proration of the consideration payable to Merchants stockholders who elect to receive the cash election consideration and/or the stock election consideration will not be known until Community Bank System tallies the results of the elections, which will not occur until near or after the closing of the Merger.

Q: How will Merchants stock options be treated in the Merger?

A: Each Merchants stock option outstanding and unexercised immediately prior to the effective time of the Merger, whether or not then vested or exercisable, will be cancelled and automatically converted into the right to receive a cash amount equal to the aggregate number of Merchants shares subject to such option *multiplied by* the excess of the value of the mixed election consideration over the exercise price of such option.

Q: How will shares of Merchants common stock subject to vesting or forfeiture restrictions be treated in the Merger?

Each share of Merchants common stock subject to vesting or forfeiture restrictions and granted under any Merchants benefit plan that is outstanding immediately prior to the effective time, whether or not then vested, will automatically vest in full, and any restrictions thereon will lapse, and such

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stock will be converted into the right to receive an amount of cash equal to the value of the mixed election consideration plus dividends, if any, accrued but unpaid as of the effective time with respect to such restricted share.

Q: How will warrants to purchase Merchants common stock be treated in the Merger?

A: Each warrant that was originally issued on April 25, 2008 by NUVO Bank & Trust Company (with respect to which Merchants issued replacement warrants on December 4, 2015), which we refer to as organizers warrants, to purchase Merchants common stock outstanding as of the effective time will be converted at the effective time into a warrant to acquire, upon payment of the amount determined by dividing the per share exercise price immediately prior to the effective time by the stock election consideration of 0.9630, the number of shares of Community Bank System common stock determined by *multiplying* (i) the number of shares of Merchants common stock which may be acquired upon exercise of such organizers warrant immediately prior to the effective time by (ii) the stock election consideration of 0.9630.

Each warrant that was originally issued on April 30, 2013 by NUVO Bank & Trust Company (with respect to which Merchants issued replacement warrants on December 4, 2015), which we refer to as 2013 warrants, to purchase Merchants common stock outstanding as of the effective time will be converted into the right to receive, at the holder's election, either (i) a cash payment in cancellation of such 2013 warrant equal to the number of shares of Merchants common stock which may be acquired upon exercise of such 2013 warrant *multiplied by* the excess, if any, of the cash election consideration of \$40.00 over the per share 2013 warrant exercise price immediately prior to the effective time or (ii) a replacement 2013 warrant certificate issued by Community Bank System and representing the right to acquire prior to the expiration date of the original 2013 warrant, upon payment of the amount determined by dividing the per share exercise price immediately prior to the effective time by the stock election consideration of 0.9630, that number of shares of Community Bank System common stock equal to the number of shares of Merchants common stock which may be acquired upon exercise of such 2013 warrant immediately prior to the effective time *multiplied by* the stock election consideration of 0.9630.

Q: Could you tell me more about Community Bank System?

A: Community Bank System is the parent company of Community Bank and is a financial holding company registered under the Bank Holding Company Act of 1956, as amended. Community Bank is a commercial banking franchise headquartered in Upstate New York, with more than 200 customer facilities and 202 ATMs ranging diagonally from Northern New York to the Southern Tier and west to Lake Erie, and in Northeastern Pennsylvania.

Community Bank is a community retail bank committed to the philosophy of serving the financial needs of customers in local communities. Community Bank emphasizes the local character of business, knowledge of the customer and customer needs, comprehensive retail and small business products, and responsive decision-making at the branch and regional levels. Community Bank and its subsidiaries offer a range of commercial and retail banking and financial services in their market areas to business, individual, agricultural and government customers. Community Bank and its employees strive to support and to actively engage in important initiatives in local communities within the market areas it serves.

Community Bank System common stock is publicly traded on the NYSE under the symbol CBU. At September 30, 2016, Community Bank System had on a consolidated basis approximately \$8.7 billion in total assets, \$7.1 billion in total deposits, \$4.9 billion in total loans and stockholders' equity of \$1.2 billion. For additional information about Community Bank System, please see "Where You Can Find More Information" beginning on page 104 of this Proxy Statement/Prospectus.

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Q: When is the Merger expected to be completed?

The parties are working to complete the Merger during late second quarter or early third quarter of 2017. Merchants and Community Bank System must first obtain the necessary regulatory approvals and the approval of the Merchants stockholders at the special meeting and satisfy other customary closing conditions. Merchants and Community Bank System cannot assure you as to when or if all the conditions to the Merger will be met, and it is possible that the parties will not complete the Merger at all.

Q: What happens if the Merger is not completed?

If the Merger is not completed, Merchants will remain an independent company. If the Merger Agreement is terminated under certain specified circumstances, Merchants may be required to pay to Community Bank System a termination fee of \$10.72 million.

Q: Does the board of directors of Merchants have a recommendation on how I should vote on the Merger Agreement?

Yes. The board of directors of Merchants unanimously determined that the Merger Agreement and the Merger are advisable and in the best interests of Merchants and its stockholders, and unanimously recommends that the stockholders of Merchants vote FOR the adoption of the Merger Agreement.

Q: Why am I being asked to cast a non-binding, advisory vote to approve the Merger-Related Executive Compensation?

The Securities and Exchange Commission (SEC), in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), adopted rules that require Merchants to seek a non-binding, advisory vote with respect to certain payments that will or may be made to Merchants named executive officers in connection with the Merger.

Q: What will happen if Merchants stockholders do not approve the Merger-Related Executive Compensation proposal at the special meeting?

Approval of the proposal related to the Merger-Related Executive Compensation is not a condition to completing the Merger. The vote with respect to the Merger-Related Executive Compensation is an advisory vote and will not be binding on Merchants regardless of whether the Merger Agreement is adopted. Accordingly, as the compensation to be paid to the Merchants executives in connection with the Merger is contractual, such compensation will or may be payable if the Merger is completed regardless of the outcome of the advisory vote.

Q: Are there any stockholders already committed to voting in favor of the Merger Agreement?

Yes. All of the directors of Merchants and another principal stockholder of Merchants have entered into voting agreements with Community Bank System requiring them to vote all of their shares in favor of adoption of the Merger Agreement. As of the record date for the special meeting, these stockholders held approximately 11% of the outstanding shares of Merchants common stock.

Q: What risks should I consider before I vote on the Merger and make my election as to the form of merger consideration?

You should read and carefully consider the risk factors set forth in section entitled Risk Factors beginning on page 15 of this Proxy Statement/Prospectus as well as the other information contained or incorporated by reference into this Proxy Statement/Prospectus, including the matters addressed in the section of this Proxy Statement/Prospectus titled Cautionary Statement Regarding Forward-Looking Statements on page 21.

Q: Is there other information I should consider?

Yes. Much of the business and financial information about each of the companies that may be important to you is not included in this document. Instead, that information is incorporated by

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reference to documents Merchants and Community Bank System separately filed with the SEC. This means that Merchants and Community Bank System can satisfy their disclosure obligations to you by referring you to one or more documents separately filed by Community Bank System or Merchants with the SEC. Please see **Where You Can Find More Information** beginning on page 104 of this Proxy Statement/Prospectus, for a list of documents that they have incorporated by reference into this document and for instructions on how to obtain copies of those documents, free of charge.

Q: When and where will Merchants stockholders meet?

A: Merchants will hold a special meeting of its stockholders on Thursday, March 23, 2017, at 10:00 a.m., Eastern time, at the DoubleTree by Hilton, 1117 Williston Road, South Burlington, Vermont 05403.

Q: Who can vote at the Merchants special meeting?

A: Holders of record of Merchants common stock at the close of business on February 2, 2017, which is the record date for the Merchants special meeting, are entitled to vote at the special meeting.

Q: How many votes must be represented in person or by proxy at the Merchants special meeting to have a quorum?

A: A majority of the shares of Merchants common stock outstanding and entitled to vote at the special meeting, present in person or represented by proxy, constitutes a quorum at the special meeting.

Q: What vote by Merchants stockholders is required to adopt the Merger Agreement?

A: Assuming a quorum is present at the Merchants special meeting, adoption of the Merger Agreement will require the affirmative vote of the holders of at least two-thirds of the outstanding shares of Merchants common stock entitled to vote. Abstentions and broker non-votes will have the same effect as shares voted AGAINST adoption of the Merger Agreement, but they will have no impact on the advisory, non-binding proposal to approve the Merger-Related Executive Compensation or the proposal to approve an adjournment of the special meeting.

Q: What do I need to do now?

A: After you have carefully read and considered the information contained or incorporated by reference into this Proxy Statement/Prospectus, please vote your shares promptly. If you hold common stock in your name as a stockholder of record, please complete, sign, date and mail your proxy card in the enclosed postage paid return envelope as soon as possible. You may also vote by telephone or through the Internet as instructed on the enclosed proxy card. If you hold your shares in street name through a bank, broker or other fiduciary, you must direct your bank or broker to vote in accordance with the instructions you receive from your bank, broker or other fiduciary. If you sign and send in your proxy and do not indicate how you want to vote, your proxy will be voted in favor of the Merger Agreement, the approval, on an advisory basis, of the Merger-Related Executive Compensation, and, if necessary, the adjournment proposal.

Q: If my shares are held in street name by my broker, will the broker vote my shares for me?

A: No. Your broker WILL NOT vote your shares unless you provide instructions on how to vote. It is important that you provide timely instruction to your broker or bank to ensure that all shares of Merchants common stock that you own are voted at the special meeting. You should instruct your broker how to vote your shares, following the directions your broker provides.

Q: What if I fail to instruct my broker?

A: If you do not provide your broker with instructions and your broker submits an unvoted proxy, referred to as a broker non-vote, the broker non-vote will have the same effect as a vote against the adoption of the Merger Agreement. Broker non-votes will have no impact on the advisory, non-binding proposal to approve the Merger-Related Executive Compensation or the proposal to approve an adjournment of the special meeting.

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Q: Can I attend the special meeting and vote my shares in person?

Yes. Although the Merchants board of directors requests that you vote your shares by mail, by telephone, or through the Internet in advance of the special meeting, all Merchants stockholders are invited to attend the special meeting. Stockholders of record on February 2, 2017 may vote in person at the special meeting. If your shares are held by a broker, bank or other nominee, then you are not the stockholder of record and you must bring to the special meeting appropriate documentation from your broker, bank or other nominee to enable you to vote at the special meeting.

Q: Can I change my vote?

Yes. If you do not hold your shares in street name, there are three ways you can change your vote at any time after you have sent in your proxy card and before your proxy is voted at the special meeting: (i) you may give written notice of revocation to Merchants corporate secretary; (ii) you may submit a new signed proxy card bearing a later date or vote again by telephone or the Internet (any earlier proxies will be automatically revoked); or (iii) you may attend the special meeting and vote in person (however, the mere presence of a stockholder at the special meeting will not constitute revocation of a previously given proxy). If you hold your shares in street name through a bank, broker or other fiduciary, you should contact your bank, broker or other fiduciary to revoke your proxy. Any written notices of revocation and other communications with respect to revocation of proxies should be addressed to Merchants as follows: Merchants Bancshares, Inc., Corporate Secretary, 275 Kennedy Drive, South Burlington, Vermont, 05403, which must be received by 5:00 p.m., Eastern time, on March 22, 2017.

Q: How do I make an election as to the form of merger consideration I wish to receive in the Merger?

Community Bank System will mail to each Merchants stockholder an election form/letter of transmittal which will contain instructions for making a selection of merger consideration and for surrendering your stock certificates in exchange for the merger consideration. American Stock Transfer & Trust Company (American Stock Transfer), the exchange agent for the Merger, must receive your properly completed election form/letter of transmittal and your stock certificates, or suitable guarantee of delivery, by no later than the election deadline in order for your choice as to the form of merger consideration to be considered with those made by the other Merchants stockholders. Merchants and Community Bank System will notify you of the election deadline.

Q: What happens if I don't make a valid election as to the form of merger consideration before the election deadline?

If you do not make a valid election as to the form of merger consideration before the election deadline, each share of Merchants common stock held by you will be converted into the right to receive a combination of \$12.00 in cash and 0.6741 shares of Community Bank System common stock. If the Merger is completed, the exchange agent will send any stockholder who does not make a valid election a new letter of transmittal that such stockholder can use to surrender his or her shares of Merchants common stock in exchange for the merger consideration.

Q: Can I change my election as to the form of merger consideration?

Yes. You can change your election as to the form of merger consideration by submitting a new election form/letter of transmittal. For a change to be effective, the exchange agent must receive your election form/letter of transmittal before the election deadline.

Q: What are the material U.S. federal income tax consequences of the Merger to me?

It is a condition to the obligation of Merchants to complete the Merger that Merchants receives a legal opinion to the effect that the Merger qualifies as reorganization within the meaning of Section 368(a) of the Internal Revenue Code, as amended, which we refer to as the Code. If, as

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expected, the Merger qualifies as a reorganization, the specific tax consequences to a U.S. holder (as defined in Material U.S. Federal Income Tax Consequences of the Merger beginning on page 54 of this Proxy Statement/Prospectus) exchanging Merchants common stock in the Merger will generally depend upon the form of consideration such U.S. holder receives in the Merger.

A U.S. holder exchanging all of its shares of Merchants common stock for solely Community Bank System common stock (and cash instead of fractional shares of Community Bank System common stock) pursuant to the Merger Agreement will generally not recognize gain or loss, except with respect to cash received instead of fractional shares of Community Bank System common stock.

A U.S. holder exchanging all of its shares of Merchants common stock for solely cash pursuant to the Merger Agreement will generally recognize gain or loss equal to the difference between the amount of cash it receives and its cost basis in its Merchants common stock.

A U.S. holder exchanging all of its shares of Merchants common stock for a combination of Community Bank System common stock and cash pursuant to the Merger Agreement will generally recognize gain (but not loss) in an amount equal to the lesser of (i) the amount of cash treated as received in exchange for Merchants common stock in the Merger and (ii) the excess of the amount realized in the transaction (i.e., the fair market value of the Community Bank System common stock at the effective time of the Merger plus the amount of cash treated as received in exchange for Merchants common stock in the Merger) over its tax basis in its surrendered Merchants common stock.

The U.S. federal income tax consequences described above may not apply to all holders of Merchants common stock. Your tax consequences will depend on your individual situation. Accordingly, we strongly urge you to consult your own tax advisor to determine the particular tax consequences of the Merger to you.

Q: Are Merchants stockholders entitled to seek appraisal or dissenters' rights if they do not vote in favor of the adoption of the Merger Agreement?

A: Yes. As a holder of Merchants common stock, you are entitled to seek appraisal or dissenters' rights under the Delaware General Corporation Law in connection with the Merger. Failure to follow precisely any of the statutory requirements could result in the loss of your appraisal rights.

Q: Should Merchants stockholders send in their stock certificates with the enclosed proxy?

A: No. Merchants stockholders SHOULD NOT send in any stock certificates now. You will receive separate written instructions for making your election and surrendering your shares of Merchants common stock.

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WHO CAN HELP ANSWER YOUR QUESTIONS

If you want to ask any questions about the Merger or the merger consideration to be issued in the Merger, you should contact:

Innisfree M&A Incorporated

501 Madison Avenue
New York, New York 10022
(212) 750-5833

You may also contact:

Community Bank System, Inc.

Scott A. Kingsley
E.V.P. and Chief Financial Officer
Community Bank System, Inc.
5790 Widewaters Parkway
DeWitt, New York 13214
(315) 445-7378

Merchants Bancshares, Inc.

Geoffrey R. Hesslink
President and Chief Executive Officer
Merchants Bancshares, Inc.
275 Kennedy Drive
South Burlington, Vermont 05403
(800) 322-5222

Both Community Bank System and Merchants file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any reports, statements or other information that Community Bank System or Merchants files at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1 800-SEC-0330 for further information on the Public Reference Room. Community Bank System's and Merchants' public filings are also available at the Internet site maintained by the SEC at <http://www.sec.gov>.

Community Bank System's and Merchants' public filings are also available from Community Bank System and Merchants, respectively, at the address shown below or at their respective websites: www.communitybankna.com or www.mbv.com. Please note that Community Bank System's and Merchants' Internet addresses are included in this Proxy Statement/Prospectus as inactive textual references only. The information contained on Community Bank System's and Merchants' websites are not incorporated by reference in this Proxy Statement/Prospectus and should not be considered part of this document.

Community Bank System has filed a registration statement to register with the SEC the shares of Community Bank System common stock to be issued to Merchants stockholders in the Merger. This document is a part of the registration statement and constitutes a Prospectus of Community Bank System and a Proxy Statement of Merchants for its special meeting of stockholders. As allowed by SEC rules, this document does not contain all the information that stockholders can find in the registration statement or the exhibits to the registration statement. The SEC allows Community Bank System and Merchants to incorporate by reference certain information into this document, which means that Community Bank System and Merchants can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is deemed to be a part of this document, except for any information which contradicts information contained directly in this document. Please see "Where You Can Find More Information" beginning on page 104 of this Proxy Statement/Prospectus to find out where you can find more information about the documents incorporated by reference.

If you wish to obtain an additional copy of this document, or any other information, without charge upon written or oral request, please see "Where You Can Find More Information" beginning on page 104 of this Proxy Statement/Prospectus to find out where you can find more information about Community Bank System and

Merchants, or contact:

Community Bank System, Inc.

Donna J. Drengel
Investor Relations
Community Bank System, Inc.
5790 Widewaters Parkway
DeWitt, New York 13214
(315) 445-7313

Merchants Bancshares, Inc.

Geoffrey R. Hesslink
President and Chief Executive Officer
Merchants Bancshares, Inc.
275 Kennedy Drive
South Burlington, Vermont 05403
(800) 322-5222

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To obtain timely delivery of these documents, you must request the information no later than March 9, 2017 in order to receive them before the special meeting.

You should rely only on the information contained in, or incorporated by reference into, this Proxy Statement/Prospectus. No one has been authorized to give any information or make any representation about the Merger or Community Bank System or Merchants that differs from, or adds to, the information in this Proxy Statement/Prospectus or in documents that are incorporated by reference herein and publicly filed with the SEC. Therefore, if anyone does give you different or additional information, you should not rely on it. You should not assume that the information contained in this Proxy Statement/Prospectus is accurate as of any date other than the date of this Proxy Statement/Prospectus, and you should not assume that any information incorporated by reference into this document is accurate as of any date other than the date of such other document, and neither the mailing of this Proxy Statement/Prospectus to Merchants stockholders nor the issuance of Community Bank System common stock in the Merger shall create any implication to the contrary.

This Proxy Statement/Prospectus does not constitute an offer to sell, or a solicitation of an offer to purchase, the securities offered by this Proxy Statement/Prospectus, or the solicitation of a proxy, in any jurisdiction to or from any person to whom or from whom it is unlawful to make such offer, solicitation of an offer or proxy solicitation in such jurisdiction.

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SUMMARY

*This summary highlights selected information from this document and may not contain all of the information that is important to you. For a more complete understanding of the Merger and for a more complete description of the legal terms of the Merger, we encourage you to read this entire Proxy Statement/Prospectus and its annexes carefully, as well as the additional documents referred to in this Proxy Statement/Prospectus. See *Where You Can Find More Information* beginning on page 104 of this Proxy Statement/Prospectus.*

The Merger Agreement is attached to this document as Annex A. Please read that document carefully. It is the legal document that governs the Merger and your rights in the Merger.

Information about the Companies (Page 22)

Community Bank System, Inc.

5790 Widewaters Parkway
DeWitt, New York 13214
(315) 445-2282

Community Bank System is a bank holding company operating Community Bank, which currently has more than 200 customer facilities and 202 ATMs in 36 counties in Upstate New York: Allegany, Broome, Cattaraugus, Cayuga, Chautauqua, Chenango, Chemung, Clinton, Delaware, Erie, Essex, Franklin, Hamilton, Herkimer, Jefferson, Lewis, Livingston, Madison, Oneida, Onondaga, Ontario, Oswego, Otsego, St. Lawrence, Saratoga, Schoharie, Schuyler, Seneca, Steuben, Tioga, Tompkins, Ulster, Warren, Washington, Wayne, and Yates, and six counties in Northern Pennsylvania: Bradford, Carbon, Lackawanna, Luzerne, Susquehanna and Wyoming. Community Bank and its subsidiaries offer a broad range of commercial banking, trust, pension administration, investment and financial services to business, individual, agricultural and government customers.

Community Bank is Community Bank System's principal operating subsidiary. At September 30, 2016, Community Bank System had on a consolidated basis approximately \$8.7 billion in total assets, \$7.1 billion in total deposits, \$4.9 billion in total loans and stockholders' equity of \$1.2 billion.

Community Bank System common stock is currently listed on the NYSE under the symbol CBU.

Community Bank System announced on December 5, 2016 that it has entered into an agreement to acquire Northeast Retirement Services, Inc. (NRS), a leading institutional provider of plan accounting, transfer agency, fund administration, trust and retirement plan services. Upon the closing of the transaction on February 3, 2017, NRS became a subsidiary of Benefit Plans Administrative Services, Inc. (BPAS), a wholly-owned subsidiary of Community Bank System. The cash and stock transaction is valued at approximately \$140 million. The foregoing transaction is referred to in this Proxy Statement/Prospectus as the NRS acquisition.

Merchants Bancshares, Inc.

275 Kennedy Drive
South Burlington, Vermont 05403
(802) 658-3400

Merchants is a publicly-held bank holding company registered under the Bank Holding Company Act of 1956, as

amended, and is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Merchants is incorporated under the laws of the State of Delaware and headquartered in South Burlington, Vermont. At September 30, 2016, Merchants had total consolidated assets of approximately \$1.99 billion (including loans of approximately \$1.47 billion), deposits of approximately \$1.50 billion and stockholders equity of approximately \$158 million.

Merchants conducts substantially all of its business through its subsidiary, Merchants Bank. Merchants Bank is a Vermont-chartered nonmember stock bank organized in 1849 with 31 full-service banking offices located throughout the State of Vermont and one full-service banking office in Massachusetts. The primary business of Merchants Bank is to attract deposits from and extend loans to consumer, institutional, municipal,

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non-profit and commercial customers. Merchants also provides wealth management and trust services through the Merchants Trust Company Division of Merchants Bank.

Merchants common stock is currently listed on the NASDAQ Global Select Market under the symbol MBVT.

Information about the Special Meeting

Date, Time and Place of the Special Meeting (Page 24)

A special meeting of Merchants stockholders will be held on Thursday, March 23, 2017, at 10:00 a.m., Eastern time, at the DoubleTree by Hilton, 1117 Williston Road, South Burlington, Vermont 05403.

Actions to be Taken at the Special Meeting (Page 24)

At the special meeting, Merchants stockholders as of February 2, 2017, the record date, will be asked to vote on a proposal to adopt the Merger Agreement, a non-binding, advisory proposal to approve the Merger-Related Executive Compensation, and if necessary, the adjournment proposal.

Record Date; Outstanding Shares; Shares Entitled to Vote (Page 24)

Only holders of record of Merchants common stock at the close of business on the record date of February 2, 2017 are entitled to notice of and to vote at the special meeting. As of the record date, there were 6,898,903 shares of Merchants common stock outstanding, held of record by approximately 856 stockholders.

Quorum; Vote Required (Page 24)

The presence in person or by proxy of the holders of a majority of the shares of Merchants common stock outstanding on the record date will constitute a quorum for the transaction of business at the special meeting.

The adoption of the Merger Agreement requires the affirmative vote of the holders of two-thirds of the outstanding shares of Merchants common stock entitled to vote at the special meeting of stockholders. Approval of the Merger-Related Executive Compensation proposal requires the affirmative vote of a majority of the votes cast on the proposal. Approval of the adjournment proposal, if necessary to solicit additional proxies if there are not sufficient votes to adopt the Merger Agreement, requires the affirmative vote of a majority of the votes cast on the proposal.

Broker non-votes and abstentions will have the same effect as a vote AGAINST the Merger Agreement, but they will have no effect on the Merger-Related Executive Compensation proposal or the adjournment proposal.

Share Ownership of Management; Voting Agreements (Page 25)

On the record date, the directors and another principal stockholder of Merchants had voting power with respect to an aggregate of 739,146 shares of Merchants common stock, or approximately 11% of the shares of the Merchants common stock then outstanding. Each such person executed an agreement that generally commits such person to vote

all of his or her shares of Merchants common stock in favor of the Merger Agreement.

Recommendation of the Merchants Board of Directors (Page 24)

Merchants board of directors has unanimously approved the Merger Agreement, and recommends a vote FOR the adoption of the Merger Agreement, FOR the approval, on an advisory basis, of the Merger-Related Executive Compensation, and FOR the adjournment proposal, if necessary.

Appraisal Rights (Page 58)

Under Delaware law, Merchants stockholders who do not vote in favor of adoption of the Merger Agreement will have the right to seek appraisal of the fair value of their Merchants common stock as determined by the Delaware Court of Chancery if the Merger is completed, but only if they submit a written demand for such an appraisal prior to the vote on adoption of the Merger Agreement and strictly comply with

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the other Delaware law procedures explained in this Proxy Statement/Prospectus. See the section entitled "Proposal 1 The Merger Appraisal or Dissenters Rights" beginning on page 58 of this Proxy Statement/Prospectus. The applicable Delaware law is reproduced in its entirety in **Annex C** to this Proxy Statement/Prospectus.

The Merger

Structure of the Merger (Page 62)

Merchants and Community Bank System are proposing a merger of Merchants with and into Community Bank System, with Community Bank System as the surviving company. Immediately following the Merger, the parties will merge Merchants Bank, a wholly-owned banking subsidiary of Merchants, with and into Community Bank, a wholly-owned banking subsidiary of Community Bank System, with Community Bank as the surviving entity (the Bank Merger).

The Merger Agreement is attached to this document as **Annex A**. We encourage you to read the Merger Agreement carefully and in its entirety as it is the legal document that governs the Merger and your rights in it. You are also encouraged to read the risk factors beginning on page 15.

Merger Consideration (Page 62)

If the Merger proposal is approved and the Merger is subsequently completed, you may elect to receive (subject to the proration procedures described below), in exchange for each outstanding share of Merchants common stock that you own, either:

\$40.00 in cash, without interest (the cash election consideration);
0.9630 shares of Community Bank System common stock, plus cash in lieu of fractional shares (the stock election consideration); or
a combination of 0.6741 shares of Community Bank System common stock and \$12.00 in cash, plus cash in lieu of fractional shares (the mixed election consideration).

Election Procedures (Page 63)

Community Bank System will mail separately an election form/letter of transmittal. Please read the instructions to the election form/letter of transmittal, and complete, sign and return it with your Merchants stock certificates or appropriate guarantee of delivery before the election deadline. Merchants and Community Bank System will notify you of the election deadline. If you do not make a valid election as to the form of merger consideration before the election deadline, all of your shares of Merchants common stock will be converted into the right to receive the mixed election consideration.

Proration Procedures (Page 63)

The merger consideration to be paid to Merchants stockholders is subject to allocation procedures that are designed to ensure that the total amount of cash paid, and the total number of shares of Community Bank System common stock issued in the Merger, as a whole, will equal as nearly as practicable the total amount of cash and number of shares that would have been paid and issued if all of the Merchants stockholders received the mixed election consideration.

Whether you receive the amount of cash and/or stock you request in your election form will depend in part on the elections of other Merchants stockholders. You may not receive the form of consideration that you elect in the Merger, and you may instead receive a pro-rata amount of cash and/or Community Bank System common stock.

The greater the oversubscription of the stock election, the less stock and more cash a Merchants stockholder making the stock election will receive. Reciprocally, the greater the oversubscription of the cash election, the less cash and more stock a Merchants stockholder making the cash election will receive. However, in no event will a Merchants stockholder who makes the cash election or the stock election receive less cash and more shares of Community Bank System common stock, or fewer shares of Community Bank System common stock and more cash, respectively, than a stockholder who makes the mixed election.

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For additional detail and for illustrative examples, see The Merger Agreement Election and Proration Procedures beginning on page 63 of this Proxy Statement/Prospectus.

Treatment of Merchants Equity Awards and Warrants (Page 67)

At the effective time of the Merger, each option granted under Merchants equity plans outstanding and unexercised, whether or not then vested or exercisable, will be cancelled and converted into the right to receive a cash payment in an amount equal to the product of the number of shares of Merchants common stock underlying the option and the excess of the value of the mixed election consideration over the exercise price of the option.

At the effective time of the Merger, each restricted stock award granted under Merchants equity plans will automatically vest in full, and any restrictions thereon will lapse, and such stock will be cancelled and converted into the right to receive a cash payment equal to the value of the mixed election consideration, plus all dividends, if any, accrued but unpaid as of the effective time of the Merger with respect to such restricted share.

At the effective time of the Merger, each organizers warrant will be converted into a warrant to acquire, upon payment of the amount determined by dividing the per share exercise price immediately prior to the effective time by the stock election consideration of 0.9630, the number of shares of Community Bank System common stock determined by *multiplying* (i) the number of shares of Merchants common stock which may be acquired upon exercise of such organizers warrant immediately prior to the effective time by (ii) the stock election consideration of 0.9630.

At the effective time of the Merger, each 2013 warrant will be converted into the right to receive, at the holder's election, either (i) a cash payment in cancellation of such 2013 warrant equal to the number of shares of Merchants common stock which may be acquired upon exercise of such 2013 warrant *multiplied by* the excess, if any, of the cash election consideration of \$40.00 over the per share 2013 warrant exercise price immediately prior to the effective time or (ii) a replacement 2013 warrant certificate issued by Community Bank System representing the right to acquire prior to the expiration date of the original 2013 warrant, upon payment of the amount determined by dividing the per share exercise price immediately prior to the effective time by the stock election consideration of 0.9630, that number of shares of Community Bank System common stock equal to the number of shares of Merchants common stock which may be acquired upon exercise of such 2013 warrant immediately prior to the effective time *multiplied by* the stock election consideration of 0.9630.

Opinion of Merchants Financial Advisor (Page 38)

In connection with the Merger, Merchants financial advisor, Piper Jaffray & Co. (Piper), delivered a written opinion to the Merchants board of directors, dated October 22, 2016, that, as of such date, and based upon and subject to the various factors, assumptions and limitations set forth in its opinion, the consideration offered in the Merger was fair, from a financial point of view, to the holders of Merchants common stock. The full text of Piper's written opinion dated October 22, 2016, which sets forth, among other things, the procedures followed, assumptions made, matters considered and qualifications and limitations on the scope of review undertaken in rendering its opinion, is attached as **Annex B** to this Proxy Statement/Prospectus and is incorporated herein by reference. **Piper's opinion was addressed to, and provided for the information and benefit of, the Merchants board of directors (in its capacity as such) in connection with its evaluation of the fairness of the merger consideration from a financial point of view, and did not address any other aspects or implications of the Merger. The opinion does not constitute a recommendation to the Merchants board of directors or to any other persons in respect of the Merger, including as to how any holder of Merchants common stock should vote at any stockholders meeting held in connection with the Merger or take, or not to take, any action in respect of the Merger. Piper's opinion does not**

address the relative merits of the Merger as compared to any other business or financial strategies that might be available to Merchants, nor does it address the underlying business decision of Merchants to engage in the Merger.

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Community Bank System common stock is traded on the NYSE under the symbol CBU. Merchants common stock is traded on the NASDAQ Global Select Market under the symbol MBVT. The following table shows the closing or last sale prices of Community Bank System common stock and Merchants common stock on October 21, 2016 and February 2, 2017. October 21, 2016 is the last full trading day prior to the announcement of the signing of the Merger Agreement. February 2, 2017 was the last practicable trading day for which information was available prior to the date of this document. The equivalent price per share of Merchants common stock is determined by multiplying the closing price of Community Bank System common stock by the 0.6741 mixed stock consideration and adding \$12.00 to such amount.

	Community Bank System	Merchants	Equivalent Market Value Per Share
Closing Sale Prices Per Share on:	Historical	Historical	
October 21, 2016	\$ 47.50	\$ 32.85	\$ 44.02
February 2, 2017	\$ 57.67	\$ 50.40	\$ 50.88

The market prices of both Community Bank System common stock and Merchants common stock will fluctuate before the Merger. Merchants and Community Bank System encourage you to obtain current market prices.

Required Regulatory Approvals (Page 57)

Community Bank System must make filings with or obtain approvals from certain regulatory authorities to effect the Merger. In addition, before Merchants and Community Bank System can complete the Merger, they will make all filings and obtain all regulatory approvals required for the merger of their banking subsidiaries, Community Bank and Merchants Bank. These include the approvals of the Federal Reserve Board and the Office of the Comptroller of the Currency (the OCC). In addition, Community Bank System must apply to list the common stock to be issued in the Merger on the NYSE.

Limitations on Considering Other Acquisition Proposals (Page 73)

Merchants has agreed to a number of limitations with respect to soliciting, negotiating and discussing acquisition proposals involving persons other than Community Bank System, and to certain related matters. The Merger Agreement does not, however, prohibit Merchants from considering an unsolicited bona fide acquisition proposal from a third party if certain specified conditions are met.

Conditions to Completion of the Merger (Page 78)

Each party's obligation to complete the Merger is subject to the satisfaction or waiver (to the extent permitted under applicable law) of certain other conditions, including:

the SEC declaring effective the registration statement that covers the Community Bank System common stock to be issued in the Merger;

Merchants stockholders adopting the Merger Agreement by the affirmative vote of at least two-thirds of the shares outstanding and entitled to vote at the special meeting;

Community Bank System and Merchants receiving all approvals or consents required by law from any applicable governmental agency, and all applicable notice or waiting periods expiring;

no governmental authority having imposed a materially burdensome condition in connection with granting any regulatory approval;

no court or regulatory actions, nor any judgments, orders, decrees or injunctions, having been instituted or issued by any governmental authority, court, or administrative agency preventing the consummation of the Merger;

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the representations and warranties made by Community Bank System and Merchants in the Merger Agreement continuing to be true and correct as of the effective time of the Merger (subject to the materiality standards set forth in the Merger Agreement);

Merchants and Community Bank System having complied with all of their respective covenants pursuant to the Merger Agreement in all material respects;

the NYSE approving for listing the Community Bank System common stock to be issued in the Merger; Cadwalader, Wickersham & Taft LLP (Cadwalader), Community Bank System's outside legal counsel, delivering an opinion to Community Bank System, dated as of the closing date of the Merger, to the effect that the Merger will qualify as a reorganization under Section 368(a) of the Code;

Goodwin Procter LLP (Goodwin Procter), Merchants' outside legal counsel, delivering an opinion to Merchants, dated as of the closing date of the Merger, to the effect that the Merger will qualify as a reorganization under Section 368(a) of the Code; and

Neither Merchants nor Community Bank System having experienced a material adverse effect.

Fees and Expenses; Termination Fee (Page 80)

Merchants and Community Bank System will each pay its own expenses in connection with the Merger, except that the parties will share equally all costs associated with the printing and mailing of this document. If, however, the Merger Agreement is terminated under certain circumstances, Merchants must pay a termination fee of \$10.72 million as set forth in the Merger Agreement. Generally, the termination fee will become payable in connection with Merchants accepting a competing third party acquisition offer.

Terminating the Merger Agreement (Page 78)

Either Merchants or Community Bank System may terminate the Merger Agreement under certain circumstances, including if:

both companies consent in writing to the termination;

the Merger is not completed by July 22, 2017; however, neither party has the right to terminate the Merger Agreement if such party was in breach of its obligations under the Merger Agreement and such breach was the cause of the failure of the Merger to be consummated by such date (if on such expiration date all conditions to the Merger have been satisfied or waived or are capable of being satisfied by the closing other than the condition relating to the receipt of required regulatory approvals, then either party has the right to extend the expiration date by an additional three month period);

any governmental entity issues a final order prohibiting the completion of the Merger;

Merchants stockholders do not approve the Merger Agreement at the special meeting; and the other party materially breaches, and does not cure within 30 days of notice of such breach from the other party, any of the representations, warranties or covenants it has made under the Merger Agreement, which would constitute a failure of a condition to closing of such breaching party.

Merchants may terminate the Merger Agreement (i) if Community Bank System's stock price falls below thresholds set forth in the Merger Agreement and Community Bank System does not increase the stock consideration in the Merger pursuant to a prescribed formula in the Merger Agreement, or (ii) in order to enter into a definitive agreement with respect to a superior proposal, as defined in the Merger Agreement, subject to payment of a \$10.72 million termination fee to Community Bank System.

Community Bank System may terminate the Merger Agreement if the Merchants board of directors effects an adverse recommendation change (*i.e.*, (i) withdrawing, modifying or qualifying in a manner adverse to Community Bank System the approval, recommendation or declaration of advisability by the Merchants board of directors set forth in

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this Proxy Statement/Prospectus that the Merchants stockholders vote to adopt

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the Merger Agreement, (ii) recommending, endorsing or otherwise declaring as advisable the adoption of any acquisition proposal, (iii) resolving, agreeing or proposing to take any such actions or (iv) submitting the Merger Agreement to Merchants stockholders without recommendation).

Community Bank System may terminate the Merger Agreement if any governmental authority has denied or rescinded any required regulatory approval or imposed a materially burdensome regulatory condition on Community Bank System in connection with granting any regulatory approval.

Termination Fee (Page 80)

Merchants will owe Community Bank System a \$10.72 million termination fee if:

(i)(a) either party terminates the Merger Agreement in the event that approval by the stockholders of Merchants is not obtained at the Merchants special meeting or in the event that the Merger is not consummated by the expiration date; or (b) Community Bank System terminates the Merger Agreement as a result of any breach of any representation, warranty, covenant or agreement by Merchants that cannot or has not been cured within 30 days of notice of such breach; (ii) a third party acquisition proposal has been made prior to such termination; and (iii) within 12 months of such termination, Merchants enters into a definitive agreement with respect to an acquisition proposal or consummates an acquisition proposal; or

Community Bank System terminates the Merger Agreement as a result of the Merchants board of directors or any committee thereof effecting an adverse recommendation change; or

Community Bank System terminates the Merger Agreement as a result of Merchants failure to comply in all material respects with its obligations under the Merger Agreement with respect to third party acquisition proposals or its failure to call, give notice of, convene and hold the special meeting; or

Community Bank System terminates the Merger Agreement as a result of (i) a tender offer or exchange offer for 15% or more of the outstanding shares of Merchants common stock being commenced and Merchants not providing to its stockholders, within ten business days after the commencement of such tender or exchange offer, a statement that the Merchants board of directors recommends rejection of such tender or exchange offer, or (ii) an acquisition proposal (other than a tender or exchange offer covered by clause (i) above) with respect to Merchants being publicly announced and, upon Community Bank System's request, Merchants failing to issue a press release announcing its opposition to such acquisition proposal and reaffirming the Merchants board of directors' recommendation that Merchants stockholders vote to adopt the Merger Agreement within five business days after such request; or

Merchants receives a superior proposal and enters into a definitive agreement with respect thereto.

The payment of the termination fee will fully discharge Merchants from any losses that may be suffered by Community Bank System based upon, resulting from or arising out of the termination of the Merger Agreement.

Interests of Merchants Directors and Executive Officers in the Merger (Page 48)

Merchants' stockholders should be aware that some of Merchants' directors and executive officers have interests in the Merger and have arrangements that are different from, or in addition to, those of Merchants stockholders in general.

These interests include:

Election of two Merchants directors to the boards of directors of Community Bank System and Community Bank upon the consummation of the Merger.

The acceleration of vesting of all unvested equity awards, which will automatically vest in full, with any restrictions thereon to lapse, and will be cancelled in exchange for a cash payment.

Payment with respect to outstanding stock options held by a director.

Payment of retention incentives to executive officers.

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Payment of severance benefits under existing employment agreements with Merchants executive officers, assuming each executive officer has a qualifying termination event in connection with the Merger.

New employment agreements between certain executive officers of Merchants and Community Bank System that will become effective upon the closing of the Merger, that, among other things, entitle each such executive to receive a cash bonus as of the effective time of the Merger and include a waiver of the executive's rights under his or her existing employment agreement with Merchants and an agreement to certain non-competition and non-solicitation covenants.

Payment of a pro-rata bonus to certain executive officers at the effective time of the Merger in a lump sum under the Merchants and Merchants Bank non-equity incentive plans.

Continued indemnification and liability insurance coverage for directors and executive officers with respect to acts or omissions occurring before the Merger.

The Merchants board of directors was aware of these interests and considered them in recommending that Merchants stockholders approve the Merger Agreement.

Differences Between Rights of Holders of Community Bank System and Merchants Stock (Page 96)

Both Merchants and Community Bank System are Delaware corporations. The rights of Merchants stockholders are currently governed by Merchants' certificate of incorporation and bylaws. If the Merger is completed, certain Merchants stockholders will become stockholders of Community Bank System and their rights will be governed by Community Bank System's certificate of incorporation and bylaws. Merchants stockholders will have different rights when they become holders of Community Bank System common stock than they currently have as holders of Merchants common stock.

Material U.S. Federal Income Tax Consequences of the Merger (Page 54)

It is a condition to the respective obligations of Merchants and Community Bank System to complete the Merger that each of Merchants and Community Bank System receives a legal opinion to the effect that the Merger qualifies as a reorganization within the meaning of Section 368(a) of the Code. If, as expected, the Merger qualifies as a reorganization, the specific tax consequences to a U.S. holder (as defined in Material U.S. Federal Income Tax Consequences of the Merger beginning on page 54 of this Proxy Statement/Prospectus) exchanging Merchants common stock in the Merger will generally depend upon the form of consideration such U.S. holder receives in the Merger.

A U.S. holder exchanging all of its shares of Merchants common stock for solely Community Bank System common stock (and cash instead of fractional shares of Community Bank System common stock) pursuant to the Merger Agreement will generally not recognize gain or loss, except with respect to cash received instead of fractional shares of Community Bank System common stock.

A U.S. holder exchanging all of its shares of Merchants common stock for solely cash pursuant to the Merger Agreement will generally recognize gain or loss equal to the difference between the amount of cash it receives and its cost basis in its Merchants common stock.

A U.S. holder exchanging all of its shares of Merchants common stock for a combination of Community Bank System common stock and cash pursuant to the Merger Agreement will generally recognize gain (but not loss) in an amount equal to the lesser of (i) the amount of cash treated as received in exchange for Merchants common stock in the Merger and (ii) the excess of the amount realized in the transaction (*i.e.*, the fair market value of the Community Bank

System common stock at the effective time of the Merger plus the amount of cash treated as received in exchange for Merchants common stock in the Merger) over its tax basis in its surrendered Merchants common stock.

The U.S. federal income tax consequences described above may not apply to all holders of Merchants common stock. Your tax consequences will depend on your individual situation. Accordingly, we strongly urge you to consult your own tax advisor to determine the particular tax consequences of the Merger to you.

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TABLE OF CONTENTS**SELECTED HISTORICAL FINANCIAL DATA**

The following tables summarize selected historical consolidated financial data for Community Bank System and Merchants. The following selected historical consolidated financial data as of and for the twelve months ended December 31, 2015, 2014, 2013, 2012 and 2011 has been derived from each company's audited consolidated financial statements. The following selected historical consolidated financial data as of and for the nine months ended September 30, 2016 and 2015 is derived from the unaudited consolidated financial statements of each company and has been prepared on the same basis as the selected historical consolidated financial data derived from the audited consolidated financial statements and, in the opinion of each company's management, reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of this data for those dates.

The information is only a summary and should be read in conjunction with each company's financial statements and related notes and management's discussions and analyses contained in the annual, quarterly and other reports filed with the SEC. See "Where You Can Find More Information" beginning on page 104 of this Proxy Statement/Prospectus.

Community Bank System, Inc. Selected Historical Financial Data

	Nine months ended September 30,		Years Ended December 31,				
	2016	2015	2015	2014	2013	2012	2011
(In thousands except per share data and ratios)							
Income Statement Data:							
Loan interest income	\$ 157,865	\$ 138,422	\$ 187,743	\$ 185,527	\$ 188,197	\$ 192,710	\$ 192,981
Investment interest income	54,323	53,196	71,879	70,693	75,962	88,690	77,988
Interest expense	8,538	8,187	11,202	11,792	26,065	50,976	61,556
Net interest income	203,650	183,431	248,420	244,428	238,094	230,424	209,413
Provision for loan losses	5,436	3,120	6,447	7,178	7,992	9,108	4,736
Noninterest income	117,005	90,151	123,303	119,020	108,748	98,955	89,283
Gain (loss) on investment securities & early retirement of long-term borrowings, net	0	0	(4)	0	(6,568)	291	(61)
Acquisition expenses, litigation settlement, and contract termination charges	342	1,318	7,037	2,923	2,181	8,247	4,831
Other noninterest expenses	199,909	166,757	226,018	223,657	219,074	203,510	185,541
Income before income taxes	114,968	102,387	132,217	129,690	111,027	108,805	103,527
Net income	\$ 77,420	\$ 71,159	\$ 91,230	\$ 91,353	\$ 78,829	\$ 77,068	\$ 73,142
Diluted earnings per share	\$ 1.74	\$ 1.72	\$ 2.19	\$ 2.22	\$ 1.94	\$ 1.93	\$ 2.01
Balance Sheet Data:							
Cash equivalents	\$ 19,110	\$ 12,395	\$ 21,931	\$ 12,870	\$ 11,288	\$ 84,415	\$ 203,082
Investment securities	2,877,644	2,917,263	2,847,940	2,512,974	2,218,725	2,818,527	2,151,370

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Loans, net of unearned discount	4,940,621	4,313,547	4,801,375	4,236,206	4,109,083	3,865,576	3,471,025
Allowance for loan losses	(46,789)	(45,588)	(45,401)	(45,341)	(44,319)	(42,888)	(42,213)
Intangible assets	482,119	384,525	484,146	386,973	390,499	387,134	360,564
Total assets	8,727,746	7,997,166	8,552,669	7,489,440	7,095,864	7,496,800	6,488,275
Deposits	7,077,419	6,148,110	6,873,474	5,935,264	5,896,044	5,628,039	4,795,245
Borrowings	236,064	660,240	403,446	440,122	244,010	830,134	830,329
Shareholders equity	1,240,582	1,045,026	1,140,647	987,904	875,812	902,778	774,583

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(In thousands except per share data and ratios)	Nine months ended September 30,		Years Ended December 31,				
	2016	2015	2015	2014	2013	2012	2011
Capital and Related Ratios:							
Cash dividends declared per share	\$0.94	\$0.91	\$1.22	\$1.16	\$1.10	\$1.06	\$1.00
Book value per share	27.97	25.48	26.06	24.24	21.66	22.78	20.94
Tangible book value per share ⁽¹⁾	18.06	17.05	15.90	15.63	12.80	13.72	11.85
Market capitalization (in millions)	2,134	1,525	1,748	1,554	1,604	1,084	1,028
Tier 1 leverage ratio	10.35 %	10.09 %	10.32 %	9.96 %	9.29 %	8.40 %	8.38 %
Total risk-based capital to risk-adjusted assets	15.51 %	15.93 %	18.08 %	18.75 %	17.57 %	16.20 %	15.51 %
Tangible equity to tangible assets ⁽¹⁾	9.66 %	9.14 %	8.59 %	8.92 %	7.68 %	7.62 %	7.12 %
Dividend payout ratio	53.6 %	52.2 %	55.5 %	51.6 %	56.0 %	54.3 %	49.3 %
Period end common shares outstanding	44,357	41,019	43,775	40,748	40,431	39,626	36,986
Diluted weighted-average shares outstanding	44,609	41,343	41,605	41,232	40,726	39,927	36,454
Selected Performance Ratios:							
Return on average assets	1.19 %	1.24 %	1.17 %	1.23 %	1.09 %	1.08 %	1.18 %
Return on average equity	8.56 %	9.40 %	8.87 %	9.65 %	9.04 %	8.82 %	10.36 %
Net interest margin	3.69 %	3.74 %	3.73 %	3.91 %	3.91 %	3.88 %	4.07 %
Noninterest income/operating income (FTE)	35.7 %	31.9 %	32.1 %	31.4 %	30.0 %	28.6 %	28.4 %
Efficiency ratio ⁽²⁾	59.6 %	58.0 %	57.9 %	57.9 %	59.3 %	57.4 %	57.6 %
Asset Quality Ratios:							
Allowance for loan losses/total loans	0.95 %	1.06 %	0.95 %	1.07 %	1.08 %	1.11 %	1.22 %
Nonperforming loans/total loans	0.47 %	0.58 %	0.50 %	0.56 %	0.54 %	0.75 %	0.85 %
Allowance for loan losses/nonperforming loans	201 %	181 %	190 %	190 %	201 %	147 %	144 %
Loan loss provision/net charge-offs	134 %	109 %	101 %	117 %	122 %	108 %	94 %
Net charge-offs/average loans	0.11 %	0.09 %	0.15 %	0.15 %	0.17 %	0.23 %	0.15 %

(1) The tangible book value per share and the tangible equity to tangible asset ratio excludes goodwill and identifiable intangible assets, adjusted for deferred tax liabilities generated from tax deductible goodwill. The ratio is not a

financial measurement required by accounting principles generally accepted in the United States of America. However, management believes such information is useful in analyzing the relative strength of Community Bank System's capital position and in evaluating its performance.

(2) Efficiency ratio provides a ratio of operating expenses to operating income. It excludes intangible amortization, goodwill impairment, acquisition expenses, litigation settlement and contract termination charges from expenses and gains and losses on investment securities and early retirement of long-term borrowings from income while adding a fully-taxable equivalent adjustment. The efficiency ratio is not a financial measurement required by accounting principles generally accepted in the United States of America. However, the efficiency ratio is used by management in assessing financial performance specifically as it relates to noninterest expense control. Management also believes such information is useful to investors in evaluating Community Bank System's performance.

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Merchants Bancshares, Inc. Selected Historical Financial Data

(In thousands except per share data and ratios)	Nine months ended September 30,		Years Ended December 31,				
	2016	2015	2015	2014	2013	2012	2011
Summary of Operations:							
Interest and dividend income	\$44,755	\$38,419	\$52,116	\$50,972	\$53,967	\$56,857	\$58,018
Interest expense	3,395	3,048	4,052	4,525	5,070	6,883	8,644
Net interest income	41,360	35,371	48,064	46,447	48,897	49,974	49,374
Provision for loan losses	905	250	250	150	800	950	750
Net interest income after provision for loan losses	40,455	35,121	47,814	46,297	48,097	49,024	48,624
Noninterest income	9,276	8,872	11,960	11,574	11,630	12,613	11,838
Noninterest expenses	34,172	31,079	43,971	42,214	39,534	40,950	40,770
Income before income taxes	15,559	12,914	15,803	15,657	20,193	20,687	15,810
Provision for income taxes	3,792	2,606	3,185	3,532	5,062	5,493	4,890
Net income	\$11,767	\$10,308	\$12,618	\$12,125	\$15,131	\$15,194	\$14,620
Share Data:							
Basic earnings per common share	\$1.71	\$1.63	\$1.98	\$1.92	\$2.40	\$2.43	\$2.35
Diluted earnings per common share	\$1.71	\$1.62	\$1.98	\$1.91	\$2.40	\$2.42	\$2.35
Cash dividends declared per common share	\$0.84	\$0.84	\$1.12	\$1.12	\$1.12	\$1.12	\$1.12
Weighted average common shares outstanding ⁽¹⁾	6,866,418	6,332,663	6,373,115	6,326,142	6,302,494	6,258,832	6,212,187
Period end common shares outstanding ⁽²⁾	6,883,644	6,338,158	6,855,294	6,327,226	6,318,708	6,282,385	6,232,783
Period-end book value per share ⁽²⁾	\$22.99	\$20.93	\$21.59	\$19.89	\$18.93	\$18.82	\$17.57
Average Balances⁽³⁾:							
Total assets	\$1,959,396	\$1,736,523	\$1,775,496	\$1,667,665	\$1,677,342	\$1,648,393	\$1,507,656
Earning assets	1,880,008	1,670,727	1,708,153	1,603,460	1,617,225	1,587,190	1,461,359
Gross loans	1,432,167	1,218,067	1,240,386	1,165,586	1,133,637	1,057,446	971,003
Investments ⁽⁴⁾	397,146	379,030	385,806	358,274	455,679	509,384	436,170
Total deposits	1,507,276	1,359,958	1,383,537	1,320,389	1,299,449	1,222,423	1,120,234
Shareholders equity	153,822	127,876	130,220	123,283	116,640	113,621	103,639
Period-End:							
Total assets	\$1,994,655	\$1,818,341	\$2,021,237	\$1,723,464	\$1,725,469	\$1,708,550	\$1,611,869
Gross loans	1,477,285	1,257,932	1,414,280	1,182,334	1,166,233	1,082,923	1,027,626
Allowance for loan losses	12,540	12,210	12,040	11,833	12,042	11,562	10,619

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Investments ⁽⁴⁾	394,489	410,390	406,925	346,272	400,835	517,233	520,939
Total deposits	1,503,840	1,387,473	1,551,439	1,308,772	1,323,576	1,271,080	1,177,880
Shareholders equity	158,287	132,646	148,054	125,821	119,611	118,221	109,537

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(1) Weighted average common shares outstanding includes an average of 281,553 and 291,561 for the nine months ending September 30, 2016 and 2015, respectively and 292,676; 301,757; 312,606; 316,920; and 318,110 shares held by the Compensation Plan for Directors and Trustees for the fiscal years ended December 31, 2015, 2014, 2013, 2012, and 2011, respectively.

(2) Period end common shares outstanding and year-end book value include 285,134 and 294,937 for the nine months ending September 30, 2016 and 2015, respectively and 299,360; 308,670; 319,854; 324,515; and 325,703 shares held by the Compensation Plan for Directors and Trustees for the fiscal years ended December 31, 2015, 2014, 2013, 2012, and 2011 respectively.

(3) 2015 Year-end balances reflect the inclusion of NUVO, average balances reflect NUVO balances for only 28 days. Additionally, the Allowance for loan losses to total loans at year-end declined due to the inclusion of NUVO loan balances and no carryover of allowance.

(4) Includes Federal Home Loan Bank stock of \$4.84 million and \$4.38 million for the nine months ended September 30, 2016 and 2015, respectively and \$3.80 million, \$4.38 million, \$7.50 million, \$8.15 million, and \$8.63 million for the fiscal year ending December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

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SUMMARY UNAUDITED PRO FORMA COMBINED CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The following table shows unaudited pro forma financial information about the financial condition and results of operations, including per share data, after giving effect to the Merger and other pro forma adjustments. The unaudited pro forma financial information assumes that the Merger is accounted for under the acquisition method of accounting for business combinations, and that the assets and liabilities of Merchants will be recorded by Community Bank System at their respective fair values as of the date the Merger is completed. The unaudited pro forma condensed combined balance sheet gives effect to the transactions as if the transactions had occurred on September 30, 2016. The unaudited pro forma condensed combined income statements for the nine months ended September 30, 2016, and the year ended December 31, 2015, give effect to the transactions as if the transactions had become effective at January 1, 2015. The unaudited selected pro forma combined financial information has been derived from and should be read in conjunction with the consolidated financial statements and related notes of Community Bank System, which are incorporated in this Proxy Statement/Prospectus by reference, the consolidated financial statements and related notes of Merchants, which are incorporated in this Proxy Statement/Prospectus by reference, and the more detailed unaudited pro forma condensed combined financial information, including the notes thereto, appearing elsewhere in this Proxy Statement/Prospectus. See Where You Can Find More Information on page 104 of this Proxy Statement/Prospectus and Unaudited Pro Forma Combined Condensed Consolidated Financial Information beginning on page 81.

The unaudited pro forma condensed combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the companies actually been combined at the beginning of each period presented, nor the impact of possible business model changes. The unaudited pro forma condensed combined financial information also does not consider any potential effects of changes in market conditions on revenues, expense efficiencies, asset dispositions, and share repurchases, among other factors, including those discussed in the section entitled Risk Factors beginning on page 15 of this Proxy Statement/Prospectus. In addition, as explained in more detail in the accompanying notes to the Unaudited Pro Forma Combined Condensed Consolidated Financial Information beginning on page 81 of this Proxy Statement/Prospectus, the preliminary allocation of the pro forma purchase price reflected in the unaudited pro forma condensed combined financial information is subject to adjustment and may vary significantly from the actual purchase price allocation that will be recorded upon completion of the Merger.

(in thousands)	Nine months ended September 30, 2016	Year ended December 31, 2015
Statements of Income		
Net interest income	\$ 245,947	\$ 298,116
Provision for loan losses	6,341	6,697
Net interest income after provision for loan losses	239,606	291,419
Noninterest revenues	126,281	135,259
Noninterest expenses	236,769	281,542

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Income before taxes	129,118	145,136
Income taxes	40,802	43,070
Net income	88,316	102,066

(in thousands) As of
September 30,
2016

Balance Sheet

Cash and cash equivalents	\$ 149,379
Securities	3,234,246
Net loans	6,362,659
Total assets	10,822,621
Deposits	8,581,580
Short-term borrowings	155,900
Subordinated debt held by unconsolidated subsidiary trusts	117,700
Securities sold under agreement to repurchase	276,083
Total shareholders' equity	1,496,027

TABLE OF CONTENTS**COMPARATIVE UNAUDITED PER SHARE DATA**

The following table summarizes the per share information for Community Bank System and Merchants on a historical, pro forma and equivalent basis. The pro forma and pro forma per equivalent share information gives effect to the Merger as if the Merger had been effective on the date presented in the case of the book value data, and as if the Merger had been effective as of the beginning of each period presented in the case of the earnings per share and the cash dividends data. As described elsewhere in this Proxy Statement/Prospectus, the stock consideration may be adjusted in the event Merchants invokes its right to terminate the Merger Agreement if the average closing price of Community Bank System common stock for a specified period prior to closing is less than \$35.77 and Community Bank System common stock underperforms a specified peer-group index by more than 20%, and Community Bank System elects to increase the stock consideration, in order that the Merger Agreement will not be terminated.

The pro forma information, while helpful in illustrating the financial characteristics of the combined company under one set of assumptions, does not reflect the impact of factors that may result as a consequence of the Merger or consider any potential impacts of current market conditions or the Merger on revenues, expense efficiencies, asset dispositions, and share repurchases, among other factors, nor the impact of possible business model changes. As a result, the pro forma results are not necessarily indicative of what would have occurred had the Merger taken place on the assumed dates, nor do they represent an attempt to predict or suggest future results. You should read the information in the following table in conjunction with the historical financial information and related notes contained in the annual, quarterly and other reports filed by Community Bank System or Merchants with the SEC. See **Where You Can Find More Information** beginning on page 104 of this Proxy Statement/Prospectus. You should not rely on the pro forma information as being indicative of the results that Community Bank System will achieve in the Merger. The information below should be read in conjunction with **Unaudited Pro Forma Combined Condensed Consolidated Financial Information** beginning on page 81 of this Proxy Statement/Prospectus.

	Historical Community Bank System		Pro Forma Combined Merchants Company ⁽¹⁾⁽²⁾⁽³⁾ Equivalent ⁽⁴⁾	
For the nine months ended September 30, 2016:				
Basic Earnings per share	\$ 1.75	\$ 1.71	\$ 1.81	\$ 1.74
Diluted Earnings per share	1.74	1.71	1.79	1.72
Cash Dividends	0.94	0.84	0.94	0.91
Book Value at September 30, 2016	27.97	22.99	30.53	29.40
For the year ended December 31, 2015:				
Basic Earnings per share	\$ 2.21	\$ 1.98	\$ 2.23	\$ 2.15
Diluted Earnings per share	2.19	1.98	2.21	2.13
Cash Dividends	1.22	1.12	1.22	1.17

The pro forma combined basic earnings and diluted earnings of Community Bank System common stock is based on the pro forma combined net income for Community Bank System and Merchants divided by total pro forma common shares or diluted common shares of the combined entities. The pro forma information includes

(1) adjustments related to the fair value of assets and liabilities and is subject to adjustment as additional information becomes available and as additional analyses are performed. The pro forma information does not include transactional costs or anticipated cost savings or adjustments related to the fair value of assets and liabilities.

(2)

The pro forma combined book value of Community Bank System common stock is based on the pro forma combined common stockholders' equity of Community Bank System and Merchants divided by total pro forma common shares of the combined entities. The pro forma information does not include transactional costs or anticipated cost savings or adjustments related to the fair value of assets and liabilities.

(3) Cash dividend amounts are the same as historical because no change in dividend policy is expected as a result of the Merger.

The Merchants equivalent is calculated by multiplying the amounts in the Combined Company column times the (4)0.9630 exchange ratio, which represents the number of shares of Community Bank System common stock

Merchants stockholders who make a stock election will receive for each share of Merchants common stock owned.

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RISK FACTORS

In addition to the other information contained in or incorporated by reference into this Proxy Statement/Prospectus, including the matters addressed under the section titled Cautionary Statement Regarding Forward-Looking Statements, you should consider carefully the risk factors described below in deciding how to vote. You should also read and consider the risk factors associated with the businesses of Community Bank System and Merchants because these risk factors may affect the operations and financial results of the combined company. Community Bank System's risk factors may be found in Community Bank System's Annual Report on Form 10-K for the year ended December 31, 2015 and subsequent quarterly reports on Form 10-Q. Merchants' risk factors may be found in Merchants' Annual Report on Form 10-K for the year ended December 31, 2015 and subsequent quarterly reports on Form 10-Q. See Where You Can Find More Information.

Risks Related to the Merger

The value of the stock consideration will vary with changes in Community Bank System's stock price.

Upon completion of the Merger, each share of Merchants common stock will be converted into the right to receive the stock election consideration, the cash election consideration, or the mixed election consideration, subject to proration as set forth in the Merger Agreement. The exchange ratio for the stock portion of the merger consideration is fixed. Any change in the market price of Community Bank System common stock will affect the implied value of the merger consideration that Merchants stockholders will receive upon completion of the Merger. Accordingly, at the time of the special meeting and at the time that elections are due, you will not know or be able to determine the value of the stock election consideration or mixed election consideration. Stock price changes may result from a variety of factors, including general market and economic conditions, changes in Community Bank System's and Merchants' respective businesses, operations and prospects, and regulatory considerations. Many of these factors are beyond the control of Community Bank System and Merchants.

You may not receive the form of merger consideration that you elect.

The consideration to be received by Merchants stockholders in the Merger is subject to proration and adjustment procedures that are designed to ensure, as nearly as practicable, that the total cash amount of consideration and the total number of shares of Community Bank System common stock issued, as a whole, will equal the total amount of cash and number of shares that would have been paid and issued if all of the Merchants stockholders received the mixed election consideration. Accordingly, unless you elect to receive a combination of 0.6741 shares of Community Bank System common stock and \$12.00 in cash per share for your Merchants shares, there is no assurance that you will receive the form of consideration that you elect with respect to all shares of Merchants common stock you hold.

There is a risk that you will receive a portion of the merger consideration in the form that you do not elect, which could result in, among other things, tax consequences that differ from those that would have resulted had you received the form of consideration you elected, including with respect to the recognition of taxable gain to the extent cash is received. For illustrative examples of how the proration procedures would work in the event there is an oversubscription of the cash election or stock election in the Merger, see The Merger Agreement Election and Proration Procedures beginning on page 63 of this Proxy Statement/Prospectus.

Community Bank System and Merchants will be subject to business uncertainties and contractual restrictions while the Merger is pending.

Uncertainty about the effect of the Merger and the NRS acquisition on employees and customers may have an adverse effect on Merchants and Community Bank System. These uncertainties may impair Community Bank System's or Merchants' ability to attract, retain and motivate key personnel until the Merger is consummated, and could cause customers and others that deal with Merchants or Community Bank System to seek to change existing business relationships with Merchants or Community Bank System. Retention of certain employees by Merchants may be challenging while the Merger is pending, as certain employees may experience uncertainty about their future roles with Community Bank System. If key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with

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Community Bank System, Community Bank System's business following the Merger could be harmed. In addition, the Merger Agreement restricts Merchants from operating its business other than in the ordinary course, and prohibits it from taking specified actions until the Merger occurs without the consent of Community Bank System. These restrictions may prevent Merchants from pursuing business opportunities that may arise prior to the completion of the Merger. Please see the section entitled "The Merger Agreement - Conduct of Business Pending the Merger" beginning on page 68 of this Proxy Statement/Prospectus for a description of the restrictive covenants applicable to Merchants.

There is no assurance when or even if the Merger will be completed.

Completion of the Merger is subject to satisfaction or waiver of a number of conditions, including among others the adoption of the Merger Agreement by Merchants stockholders and regulatory approvals. See the section entitled "The Merger Agreement" beginning on page 62 of this Proxy Statement/Prospectus. There can be no assurance that Community Bank System and Merchants will be able to satisfy the closing conditions or that closing conditions beyond their control will be satisfied or waived.

Community Bank System and Merchants can agree at any time to terminate the Merger Agreement, even if Merchants stockholders have already voted to adopt the Merger Agreement. Community Bank System and Merchants can also terminate the Merger Agreement under other specified circumstances.

The fairness opinion delivered to Merchants' board of directors does not reflect changes in circumstances subsequent to the date of the fairness opinion.

Piper Jaffray & Co., financial advisor to Merchants in connection with the Merger, delivered its opinion to the board of directors of Merchants on October 22, 2016. The opinion of Piper speaks only as of such date. Changes in the operations and prospects of Merchants or Community Bank System, general market and economic conditions and other factors beyond the control of Merchants or Community Bank System may significantly alter the value of Merchants or the price of shares of Community Bank System common stock or Merchants common stock by the time the Merger is completed. Piper's opinion does not speak as of the time the Merger will be completed or as of any date other than the date of such opinion. For a description of Piper's opinion, please see the section entitled "The Merger - Opinion of Merchants' Financial Advisor," beginning on page 38 of this Proxy Statement/Prospectus. For a description of the other factors considered by the Merchants board of directors in determining to approve the Merger and the other transactions contemplated in the Merger Agreement, please see the sections entitled "The Merger - Background of the Merger," and "The Merger - Merchants' Reasons for the Merger; Recommendation of Merchants' Board of Directors," beginning on pages 34 and 36, respectively, of this Proxy Statement/Prospectus.

Community Bank System may fail to implement the Merger and the NRS acquisition successfully, achieve savings and realize the other anticipated benefits from the Merger and the NRS acquisition, which would adversely affect Community Bank System's financial condition and results of operations.

The Merger and the NRS acquisition involve the integration of three companies that have previously operated independently. The difficulties of combining the operations of the three companies include: integrating personnel with diverse business backgrounds; integrating core processing systems and converting customers to new systems; and retaining key employees. As a result, Community Bank System may not be able to operate the combined company as effectively as it expects. Community Bank System may also fail to achieve the anticipated potential benefits of the Merger and/or the NRS acquisition as quickly or as cost effectively as it anticipates or may not be able to achieve those benefits at all. The management of Community Bank System will have to dedicate substantial effort to integrating the three companies and, therefore, its focus and resources may be diverted from other strategic opportunities and from operational matters.

In addition, certain employees of Merchants or NRS may not be employed after the Merger. Employees of Merchants or NRS that Community Bank System wishes to retain may elect to terminate their employment as a result of the Merger or NRS acquisition, respectively, which could delay or disrupt the integration process. It is possible that the integration process could result in the disruption of the ongoing business of Community Bank System and its subsidiaries following the Merger and the NRS acquisition or cause inconsistencies in standards, controls, procedures and policies that adversely affect the ability of Community

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Bank System and its subsidiaries to maintain relationships with Merchants' or NRS's customers and employees or to achieve the anticipated benefits of the Merger and the NRS acquisition.

The unaudited pro forma condensed combined financial information included in this document is preliminary and the actual financial condition and results of operations of Community Bank System after the Merger may differ materially.

The unaudited pro forma condensed combined financial information in this document is presented for illustrative purposes only and is not necessarily indicative of what Community Bank System's actual financial condition or results of operations would have been had the Merger been completed on the dates indicated. The unaudited pro forma condensed combined financial information reflects adjustments, which are based upon preliminary estimates, to record the Merchants' identifiable assets acquired and liabilities assumed at fair value and the resulting goodwill recognized. The purchase price allocation reflected in this document is preliminary, and final allocation of the purchase price will be based upon the actual purchase price and the fair value of the assets and liabilities of Merchants as of the date of the completion of the Merger. Accordingly, the final acquisition accounting adjustments may differ materially from the pro forma adjustments reflected in this document. For more information, see "Unaudited Pro Forma Combined Condensed Consolidated Financial Statements" beginning on page 81 of this Proxy Statement/Prospectus.

Additional growth will subject Community Bank System to additional regulation, increased supervision and increased costs.

The Dodd-Frank Act imposes additional regulatory requirements on institutions with \$10 billion or more in assets. Community Bank System had \$8.7 billion in assets as of September 30, 2016. If the pending Merger with Merchants is completed, then Community Bank System will have more than \$10 billion in assets and, as a result, will be subject to the additional regulatory requirements, increased supervision and increased costs, including but not limited to the following:

Regulatory stress testing requirements, whereby Community Bank System would be required to conduct an annual stress test;

The requirement to maintain an internal risk committee;

A modified methodology for calculating FDIC insurance assessments and potentially higher assessment rates as a result of institutions with \$10 billion or more in assets being required to bear a greater portion of the cost of raising the reserve ratio to 1.35% as required by the Dodd-Frank Act;

Supervision, examination and enforcement by the Consumer Financial Protection Bureau (CFPB) with respect to consumer financial protection laws; and

A cap on the interchange fees that may be charged in certain electronic debit and prepaid card transactions. The maximum permissible interchange fee for electronic debit transactions is the sum of 21 cents per transaction and five basis points multiplied by the value of the transaction. In addition, an issuer may charge up to one cent on each transaction as a fraud prevention adjustment if the issuer meets certain fraud prevention standards.

The imposition of these regulatory requirements and increased supervision may require additional commitment of financial resources to regulatory compliance and may increase Community Bank System's cost of operations. Further, the results of the stress testing process may lead Community Bank System to retain additional capital or alter the mix

of its capital components.

Regulatory approvals may not be received, may take longer than expected or impose conditions that are not presently anticipated.

Before the Merger may be completed, Community Bank System must obtain various approvals or consents, including approvals or consents from the OCC and the Federal Reserve Board. These governmental entities, including the OCC, may impose conditions on the completion of the Merger or require changes to the terms of the Merger Agreement or the manner in which Merchants or Community Bank System conducts their respective businesses. Although Community Bank System and Merchants do not currently expect that any

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such conditions or changes would be imposed, there can be no assurance that they will not be. Such conditions or changes could have the effect of delaying completion of the Merger or imposing additional costs on or limiting the revenues of Community Bank System, any of which might have a material adverse effect on Community Bank System following the Merger.

There can be no assurance as to whether the regulatory approvals will be received, the timing of those approvals, or whether any conditions will be imposed.

Certain of Merchants officers and directors have interests that are different from, or in addition to, interests of Merchants stockholders generally.

Merchants stockholders should be aware that some of Merchants directors and executive officers have interests in the Merger and have arrangements that are different from, or in addition to, those of Merchants stockholders in general.

These interests include:

Election of two Merchants directors to the boards of directors of Community Bank System and Community Bank upon the consummation of the Merger.

The acceleration of vesting of all unvested equity awards, which will automatically vest in full, with any restrictions thereon to lapse, and will be cancelled in exchange for a cash payment.

Payment with respect to outstanding stock options held by a director.

Payment of retention incentives to executive officers.

Payment of severance benefits under existing employment agreements with Merchants executive officers, assuming each executive officer has a qualifying termination event in connection with the Merger.

New employment agreements between certain executive officers of Merchants and Community Bank System that will become effective upon the closing of the Merger, that, among other things, entitle each such executive to receive a cash bonus as of the effective time of the Merger and include a waiver of the executive's rights under his or her existing employment agreement with Merchants and an agreement to certain non-competition and non-solicitation covenants.

Payment of a pro-rata bonus to certain executive officers at the effective time of the Merger under the Merchants and Merchants Bank non-equity incentive plans.

Continued indemnification and liability insurance coverage for directors and executive officers with respect to acts or omissions occurring before the Merger.

For a more complete description of these interests, see The Merger Interests of Merchants Directors and Executive Officers in the Merger beginning on page 48 of this Proxy Statement/Prospectus.

The shares of Community Bank System common stock that may be received by Merchants stockholders as a result of the Merger will have different rights from the shares of Merchants common stock they currently hold.

Following completion of the Merger, Merchants stockholders who receive the stock consideration will no longer be stockholders of Merchants but will instead be stockholders of Community Bank System. There will be important differences between the current rights of Merchants stockholders and the rights of Community Bank System

stockholders that may be important to Merchants stockholders. See the section of this Proxy Statement/Prospectus entitled Comparison of Rights of Holders of Merchants Common Stock and Community Bank System Common Stock commencing on page 26 for a detailed description of the stockholder rights of each corporation.

The price of Community Bank System common stock may be affected by factors different from those affecting the shares of Merchants common stock currently, and could decrease after the Merger.

Upon completion of the Merger, holders of Merchants common stock who receive stock consideration will become stockholders of Community Bank System. Community Bank System common stock could decline in value after the Merger. The market value of Community Bank System common stock fluctuates based upon

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various factors, including changes in the business, operations or prospects of Community Bank System, market assessments of the Merger and/or the NRS acquisition, regulatory considerations, market and economic considerations, and other factors. Further, the market price of Community Bank System common stock after the Merger may be affected by factors different from those currently affecting the common stock of Community Bank System or Merchants. The businesses of Community Bank System and Merchants differ and, accordingly, the results of operations of the combined company and the market price of Community Bank System's shares of common stock after the Merger may be affected by factors different from those currently affecting the independent results of operations and market price of each of Community Bank System or Merchants. For a discussion of the businesses of Community Bank System and Merchants and of certain factors to consider in connection with their businesses, see the documents incorporated by reference into this Proxy Statement/Prospectus and referred to under "Where You Can Find More Information" beginning on page 104.

Merchants stockholders will have limited ability to exercise influence over management of the combined organization.

Merchants stockholders currently have the right to vote in the election of the board of directors of Merchants and on other matters affecting Merchants. Upon the completion of the Merger, each Merchants stockholder who receives shares of Community Bank System common stock will become a stockholder of Community Bank System with a percentage ownership of the combined organization that is much smaller than the stockholder's percentage ownership of Merchants. It is expected that the former common stockholders of Merchants as a group will receive shares in the Merger constituting less than 9.45% of the outstanding shares of Community Bank System common stock immediately after the Merger. Merchants stockholders will not have separate approval rights with respect to any actions or decisions of Community Bank System or have separate representation on Community Bank System's board of directors. Because of this, Merchants stockholders will have significantly less influence on the management and policies of Community Bank System than they now have on the management and policies of Merchants.

Merchants stockholders who hold their stock certificates and make elections will be unable to sell their shares in the market pending the Merger.

Merchants stockholders who wish to elect the form of merger consideration that they receive must complete an election form and deliver their Merchants stock certificates. This means that during the time between when the election is made and the date the Merger is completed, Merchants stockholders will be unable to sell their Merchants common stock. If the Merger is unexpectedly delayed, this period could extend for a significant period of time. Merchants stockholders can shorten the period during which they cannot sell their shares by delivering their election shortly before the election deadline. However, elections received after the election deadline will not be accepted or honored.

If the Merger is not completed, Merchants will have incurred substantial expenses without its stockholders recognizing the expected benefits.

Merchants has incurred substantial expenses in connection with the Merger. If the Merger is not completed,

Merchants expects that it will have incurred approximately \$2.36 million in Merger-related expenses. These expenses would likely have a material adverse impact on the operating results of Merchants because it would not have realized the expected benefits of the Merger. Furthermore, if the Merger Agreement is terminated under certain circumstances, Merchants may be required to pay a termination fee of \$10.72 million to Community Bank System. The payment of the termination fee could have a material adverse effect on Merchants financial condition. See The Merger Agreement Termination and The Merger Agreement Termination Fee beginning on pages 78 and 80, respectively, of this Proxy Statement/Prospectus.

The Merger Agreement limits Merchants ability to pursue alternatives to the Merger.

The Merger Agreement limits Merchants ability to initiate, solicit, encourage or knowingly facilitate any inquiries or competing third-party proposals, or knowingly engage in any negotiations, or provide any confidential information, or have any discussions with any person relating to a proposal to acquire all or a significant part of Merchants. In addition, Merchants has agreed to pay Community Bank System a

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termination fee in the amount of \$10.72 million in the event that the Merger Agreement is terminated for certain reasons. These provisions may discourage a potential competing acquirer that would have an interest in acquiring all or a significant part of Merchants from considering or proposing that acquisition, even if it were prepared to pay consideration with a higher per share market price than that proposed in the Merger, or may result in a potential competing acquirer proposing to pay a lower per share price to acquire Merchants than it might otherwise have proposed to pay.

Goodwill incurred in the Merger may negatively affect Community Bank System's financial condition.

To the extent that the merger consideration, consisting of cash plus the number of shares of Community Bank System common stock issued or to be issued in the Merger, exceeds the fair value of the net assets, including identifiable intangibles of Merchants, that amount will be reported as goodwill by Community Bank System. In accordance with current accounting guidance, goodwill will not be amortized but will be evaluated for impairment annually. A failure to realize expected benefits of the Merger could adversely impact the carrying value of the goodwill recognized in the Merger, and in turn negatively affect Community Bank System's financial condition.

If the Merger fails to qualify as a reorganization within the meaning of Section 368(a) of the Code, Merchants stockholders will be required to recognize gain or loss on the exchange of their shares of Merchants common stock in the Merger for U.S. federal income tax purposes.

It is a condition to the respective obligations of Merchants and Community Bank System to complete the Merger that each of Merchants and Community Bank System receives a legal opinion to the effect that the Merger qualifies as reorganization within the meaning of Section 368(a) of the Code. None of these opinions will be binding on the Internal Revenue Service. Merchants and Community Bank System have not sought and will not seek any ruling from the Internal Revenue Service regarding any matters relating to the Merger, and as a result, there can be no assurance that the Internal Revenue Service will not assert, or that a court would not sustain, a position contrary to any of the conclusions set forth herein. If the Merger fails to qualify as a reorganization within the meaning of Section 368(a) of the Code, Merchants stockholders will be required to recognize gain or loss on the exchange of their shares of Merchants common stock in the Merger for U.S. federal income tax purposes. In addition, Merchants will be treated as having sold all of its assets to Community Bank System in a taxable transaction, and will recognize taxable gain to the extent the sum of the total consideration paid by Community Bank System to the Merchants stockholders, plus the liabilities of Merchants, exceeds the tax basis of Merchants in its assets, including its tax basis in its bank and other subsidiaries. Community Bank System would succeed to and become liable for any such Merchants corporate tax as a consequence of the Merger. For further information, see Material U.S. Federal Income Tax Consequences of the Merger beginning on page 54 of this Proxy Statement/Prospectus.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this Proxy Statement/Prospectus that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the Securities Exchange Act), and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words may, will, should, could, would, plan, potential, estimate, project, believe, intend, anticipate, expect, target and similar.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions and the risks and other factors set forth in the Risk Factors section beginning on page 15 of this Proxy Statement/Prospectus.

Additional factors that could cause the results of Community Bank System or Merchants to differ materially from those described in the forward-looking statements can be found in the filings made by Community Bank System and Merchants with the Securities and Exchange Commission, including the Community Bank System Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and subsequent quarterly reports on Form 10-Q, and the Merchants Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and subsequent quarterly reports on Form 10-Q.

Because of these and other uncertainties, Community Bank System's and Merchants' actual results, performance or achievements, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, Community Bank System's and Merchants' past results of operations do not necessarily indicate Community Bank System's and Merchants' combined future results. You should not place undue reliance on any of the forward-looking statements, which speak only as of the dates on which they were made. Neither Community Bank System nor Merchants is undertaking an obligation to update these forward-looking statements, even though its situation may change in the future, except as required under the federal securities laws. All forward-looking statements contained in this document are qualified by these cautionary statements.

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THE COMPANIES

Community Bank System

Community Bank System is a Delaware corporation registered as a financial holding company under the Bank Holding Company Act of 1956, as amended. Community Bank System was incorporated in April 1983. At September 30, 2016, Community Bank System had on a consolidated basis approximately \$8.7 billion in total assets, \$7.1 billion in total deposits, \$4.9 billion in total loans and stockholders' equity of \$1.2 billion. Its common stock is publicly traded on the NYSE under the symbol CBU. Community Bank System, with its principal executive offices in DeWitt, New York, is the parent company of Community Bank, and is among the country's 150 largest financial institutions.

Community Bank is a commercial banking franchise with more than 200 customer facilities and 202 ATMs stretching diagonally from Northern New York to the Southern Tier and west to Lake Erie, and in Northern Pennsylvania. Community Bank is a national bank and a member of the Federal Reserve System and the Federal Home Loan Bank System, and its deposits are insured by the FDIC, up to applicable limits.

Community Bank System's business strategy is to operate as a profitable, diversified financial services company providing a variety of banking and other financial services, with an emphasis on consumer and residential mortgage lending and commercial business loans to small and medium-sized businesses. As a result of consolidation of small to medium-sized financial institutions and the de-emphasis on retail branch banking by larger bank holding companies in the markets Community Bank serves, it believes there is a significant opportunity for a community-focused bank to provide a full range of financial services to small and middle-market commercial and retail customers. Community Bank's branches are located in small towns and villages where competition is less intense. It emphasizes comprehensive retail and small business products and responsive, decentralized decision-making which reflect Community Bank's knowledge of its local markets and customers.

Through its subsidiaries, Community Bank System offers a wide range of commercial and retail banking and financial services to businesses, individuals, agricultural and government customers. Community Bank's account services include checking, interest-bearing checking, money market, savings, certificates of deposit and individual retirement accounts. It also offers residential and farm loans, business lines of credit, working capital facilities, inventory and dealer floor plans, as well as installment, commercial, term and student loans. Community Bank's lending focuses predominantly on consumer and small to medium-sized business borrowers, which enables its loan portfolio to be highly diversified. Because Community Bank believes that there is a significant potential market for financial services and products, it offers a full range of services to satisfy its customers' financial needs. In addition to traditional banking services and products, it offers personal trust, employee benefit trust, benefits administration and consulting, investment and insurance services to customers in our banking markets as well as in other parts of the country. Community Bank's subsidiary, OneGroup NY, Inc., is a regional insurance broker with headquarters in Syracuse, New York. Community Bank System's wholly-owned subsidiary, BPAS, is a leading provider of employee benefits administration and trust services, and actuarial and consulting services to customers on a national scale.

Community Bank System announced on December 5, 2016 that it has entered into an agreement to acquire NRS, a leading institutional provider of plan accounting, transfer agency, fund administration, trust and retirement plan services. Upon the closing of the transaction on February 3, 2017, NRS became a subsidiary of BPAS. The cash and stock transaction is valued at approximately \$140 million.

For additional information concerning the business of Community Bank System and its financial condition, results of

operations and prospects, you should refer to the documents incorporated in this document by reference. See [Where You Can Find More Information](#) on [page 104](#) of this Proxy Statement/Prospectus.

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Merchants Bancshares, Inc.

Merchants is a publicly-held bank holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to supervision, regulation and examination by the Federal Reserve Board. Merchants is incorporated under the laws of the State of Delaware and headquartered in South Burlington, Vermont. At September 30, 2016, Merchants had total consolidated assets of approximately \$1.99 billion (including loans of approximately \$1.47 billion), deposits of approximately \$1.50 billion and stockholders' equity of approximately \$158 million.

Merchants conducts substantially all of its business through its subsidiary, Merchants Bank. Merchants Bank is a Vermont-chartered nonmember stock bank organized in 1849 with 31 full-service banking offices located throughout the State of Vermont and one full-service banking office in Massachusetts. The primary business of Merchants Bank is to attract deposits from and extend loans to consumer, institutional, municipal, non-profit and commercial customers. Merchants also provides wealth management and trust services through the Merchants Trust Company Division of Merchants Bank.

Merchants Bank's deposits are insured by the FDIC to the maximum extent provided by law, and it is subject to supervision and regulation by the FDIC and the Vermont Department of Financial Regulation. Merchants Bank maintains an Internet website at www.mbvt.com. Information on Merchants Bank's website should not be considered a part of this Proxy Statement/Prospectus.

Merchants' principal executive offices are located at 275 Kennedy Drive, South Burlington, Vermont 05403, and its telephone number is (802) 658-3400.

For additional information concerning the business of Merchants and its financial condition, results of operations and prospects, you should refer to the documents incorporated in this document by reference. See [Where You Can Find More Information](#) on page [104](#) of this Proxy Statement/Prospectus.

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SPECIAL MEETING OF MERCHANTS STOCKHOLDERS

Time, Date and Place of the Special Meeting

Merchants will hold a special meeting of its stockholders on Thursday, March 23, 2017 at 10:00 a.m., Eastern time, at the DoubleTree by Hilton, 1117 Williston Road, South Burlington, Vermont 05403.

Actions to be Taken at the Special Meeting

At the special meeting, Merchants stockholders will be asked to consider and vote on the following matters:

1. a proposal to adopt the Merger Agreement, which provides for the merger of Merchants with and into Community Bank System with Community Bank System as the surviving company;
2. a non-binding, advisory proposal to approve the Merger-Related Executive Compensation;
3. a proposal to approve one or more adjournments of the special meeting, if necessary or appropriate, to solicit additional proxies if there are insufficient votes at the time of the special meeting to adopt the Merger Agreement; and
4. any other business which may properly come before the special meeting or any adjournment thereof.

Record Date; Outstanding Shares; Shares Entitled to Vote

Holders of record of Merchants common stock at the close of business on February 2, 2017, are entitled to vote at the special meeting. This date is called the record date. As of the record date, there were 6,898,903 issued and outstanding shares of Merchants common stock. Merchants stockholders have one vote per share on any matter that may properly come before the special meeting.

Recommendation of the Merchants Board of Directors

The Merchants board of directors has unanimously approved the Merger Agreement and the transactions contemplated by the Merger Agreement. The board of directors of Merchants believes the Merger Agreement is advisable and in the best interests of Merchants and its stockholders and recommends that you vote your shares as follows:

- FOR the adoption of the Merger Agreement;
FOR the approval, on an advisory basis, of the Merger-Related Executive Compensation; and
FOR the adjournment of the special meeting.

Broker Non-Votes

Brokers who hold shares of Merchants common stock as nominees will not have discretionary authority to vote these shares without instructions from the beneficial owners. Any shares of Merchants common stock for which a broker has submitted an executed proxy but for which the beneficial owner has not given instructions on voting to the broker are referred to as broker non-votes. Broker non-votes will have same effect as voting AGAINST the Merger Agreement, but it will have no impact on the advisory, non-binding proposal to approve the Merger-Related Executive Compensation or the proposal to approve an adjournment of the special meeting.

Quorum; Vote Required

The presence in person or by proxy of the holders of a majority of the shares of Merchants common stock outstanding on the record date will constitute a quorum for the transaction of business at the special meeting. Abstentions will be included in determining the presence of a quorum at the special meeting. Broker non-votes would generally be included in determining the presence of a quorum; however, since the special meeting will consider and vote upon only non-discretionary matters, broker non-votes will not be included in determining the presence of a quorum.

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Proposal I: Adoption of the Merger Agreement. Adoption of the Merger Agreement requires the affirmative vote of two-thirds of the outstanding shares of Merchants common stock entitled to vote on the Merger Agreement. Failure to return a properly executed proxy card or to vote in person will have the same effect as a vote against the Merger Agreement. Abstentions and broker non-votes will have the same effect as voting AGAINST the Merger Agreement.

Proposal II: Approval of the Merger-Related Executive Compensation. Approval of the Merger-Related Executive Compensation proposal requires the affirmative vote of a majority of the votes cast on the proposal. Abstentions and broker non-votes will not affect whether the proposal is approved.

Proposal III: Approval of the adjournment proposal. The affirmative vote of a majority of the votes cast on the proposal is required to approve the proposal to adjourn the special meeting if necessary to solicit additional proxies if there are not sufficient votes to approve the Merger Agreement. Abstentions and broker non-votes will not affect whether the proposal is approved.

Share Ownership of Management; Voting Agreements

On the record date, the directors of Merchants and another principal stockholder of Merchants, including certain of their related parties, had voting power with respect to an aggregate of 739,146 shares of Merchants common stock, or approximately 11% of the shares of Merchants common stock then outstanding. All of the directors of Merchants and another principal stockholder of Merchants have agreed to vote in favor of the adoption of the Merger Agreement all of the shares of Merchants common stock that they are entitled to vote.

Voting and Revocation of Proxies

Merchants has enclosed a form of proxy with this document. To ensure your representation at the special meeting, Merchants recommends that you vote by proxy even if you plan to attend the special meeting. You can always change your vote at the special meeting. Voting instructions are included on your proxy form. If you properly complete and timely submit your proxy, your shares will be voted as you have directed. You may vote for, against, or abstain with respect to the adoption of the Merger Agreement, the approval of the Merger-Related Executive Compensation and the approval of the adjournment proposal. Proxies that are properly signed and dated but which do not specify voting instructions will be voted FOR the adoption of the Merger Agreement, FOR the approval, on an advisory basis, of the Merger-Related Executive Compensation, and FOR the proposal to adjourn the special meeting, and in the discretion of the proxy holders as to any other matter which may properly come before the special meeting.

If you deliver a properly executed and dated proxy, you may revoke the proxy at any time before it is exercised at the special meeting. You may revoke your proxy either by:

filing with Secretary of Merchants prior to the special meeting, at Merchants principal executive offices, a written revocation of the proxy;

submitting a new proxy with a later date; or
attending the special meeting and voting in person.

Being present at the special meeting, by itself, will not revoke the proxy. You must vote in person if you wish to revoke the proxy. All written notices of revocation and other communication with respect to the revocation of proxies should be addressed to:

Merchants Bancshares, Inc.
Corporate Secretary

275 Kennedy Drive
South Burlington, Vermont 05403

If your shares are held in street name, you must follow the instructions from your broker regarding voting and revocation of proxies.

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Solicitation of Proxies

Merchants will pay for the cost of this proxy solicitation. In addition to solicitation by mail, Innisfree M&A Incorporated, a proxy solicitation firm, will assist Merchants in soliciting proxies for the special meeting. Merchants will pay approximately \$15,000.00, plus expenses, for these services. Merchants will, upon request, reimburse brokers, banks and other nominees for their expenses in sending proxy materials to their customers who are beneficial owners and obtaining their voting instructions. Additionally, directors, officers and employees of Merchants may solicit proxies from stockholders by telephone, in person or through other means. These persons will not receive additional compensation, but they will be reimbursed for the reasonable out-of-pocket expenses they incur in connection with this solicitation, if any.

Other Matters

Merchants is unaware of any matter to be presented at the special meeting other than the proposal to adopt the Merger Agreement, the proposal to approve, on an advisory basis, the Merger-Related Executive Compensation, and the proposal to approve one or more adjournments of the special meeting, if necessary or appropriate, including adjournments to permit further solicitations of proxies in favor of the Merger. If other matters are properly presented at the special meeting, the persons named in the proxy will have authority to vote all properly executed and dated proxies in accordance with their judgment on any such matter.

YOUR VOTE IS IMPORTANT!

Whether or not you plan to attend the special meeting in person, Merchants urges you to submit your proxy as soon as possible by (1) calling the toll free telephone number specified on the enclosed proxy card, (2) accessing the Internet website specified on the enclosed proxy card, or (3) completing, signing and dating the enclosed proxy card and returning it in the postage paid envelope provided. If your shares are held in the name of a bank, broker or other fiduciary, please follow the instructions on the voting card provided by such entity.

If you have any questions concerning the Merger or other matters to be considered at the Merchants special meeting, would like additional copies of this Proxy Statement/Prospectus or need help voting your shares, please contact Merchants proxy solicitor:

Innisfree M&A Incorporated
501 Madison Avenue
New York, New York 10022
(212) 750-5833

PLEASE DO NOT SEND STOCK CERTIFICATES WITH THE PROXY CARD. YOU WILL BE SENT SEPARATE INSTRUCTIONS REGARDING MAKING ELECTIONS AS TO THE FORM OF MERGER CONSIDERATION YOU WOULD LIKE TO RECEIVE AND THE SURRENDER OF YOUR STOCK CERTIFICATES.

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PROPOSAL I THE MERGER

The detailed terms of the Merger are contained in the Merger Agreement attached as Annex A to this document. The following discussion and the discussion under the caption "The Merger Agreement" describe the more important aspects of the Merger and material terms of the Merger Agreement. These descriptions are only a summary and are qualified in their entirety by reference to the Merger Agreement, which is attached as Annex A. You are urged to read the Merger Agreement carefully because it is the legal document that actually governs your rights in the Merger.

General

The Merger Agreement provides that, after approval by the stockholders of Merchants and the satisfaction or waiver of the other conditions to the Merger, Merchants will merge with and into Community Bank System, with Community Bank System as the surviving company. The certificate of incorporation and bylaws of Community Bank System will be the certificate of incorporation and bylaws of the surviving company. The directors and officers of Community Bank System immediately prior to the Merger will be the directors and officers of the surviving company. In addition, two current directors of Merchants will be appointed to the boards of directors of Community Bank System and Community Bank effective as of the closing date of the Merger.

At the effective time of the Merger, each share of Merchants common stock issued and outstanding immediately prior to the effective time of the Merger will be automatically converted into the right to receive, subject to the terms and conditions of the Merger Agreement (including proration procedures), at the election of the holder thereof, the following consideration: (i) the combination of \$12.00 in cash and 0.6741 shares of Community Bank System common stock, plus cash in lieu of fractional shares; (ii) \$40.00 in cash; or (iii) 0.9630 shares of Community Bank System common stock, plus cash in lieu of fractional shares.

Immediately following the Merger of Community Bank System and Merchants, Merchants Bank will merge with and into Community Bank, with Community Bank as the surviving entity. After the Bank Merger, branches of Merchants Bank will become branches of Community Bank.

The companies expect to complete the Merger in late second quarter or early third quarter of calendar year 2017, but they must first obtain the necessary regulatory approvals and the approval of Merchants stockholders at the special meeting, and satisfy other customary closing conditions. The companies cannot assure you as to when or if all the conditions to the Merger will be met or waived, and it is possible they will not complete the Merger at all.

Background of the Merger

The board of directors and management of Merchants periodically review various strategic alternatives as part of their on-going efforts to improve Merchants banking franchise and enhance stockholder value. These reviews have focused on assessing opportunities for growth and increasing earnings organically and through acquisitions of other banks, as well as the possibility of a strategic business combination with another banking institution. The board of directors and management of Merchants also regularly review the banking industry environment, including various interest rate scenarios, regulatory compliance and non-interest expenses, and the trend towards consolidation, and in light of these and other factors, potential strategies for enhancing Merchants competitive position in this environment.

Consistent with these goals and in the ordinary course of business, members of Merchants management have, from time to time, received inquiries from other banking institutions or their advisors regarding Merchants, and engaged in

conversations with members of management of other banking institutions regarding a possible business combination, including Community Bank System. In the course of these conversations, Community Bank System expressed a general interest in expanding into Vermont through a possible strategic transaction with Merchants. However, prior to 2016, the parties did not engage in more significant discussions.

On April 1, 2016, a director of Community Bank System had a conversation with one of Merchants' directors in Plattsburgh, New York, during which the Community Bank System director noted Community Bank System's potential interest in a business combination with Merchants at a price in the high \$30's range.

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On April 11, 2016, Geoffrey Hesslink, President and Chief Executive Officer of Merchants, and Mark Tryniski, President and Chief Executive Officer of Community Bank System, met in Burlington, Vermont to discuss their respective businesses and industry trends. Mr. Hesslink and Mr. Tryniski did not specifically discuss a potential business combination during this meeting.

On May 4, 2016, the Merchants board held a special meeting in Burlington, Vermont. At this meeting, the Merchants board discussed Community Bank System's potential interest in a business combination with Merchants. The Merchants board also reviewed summary historical financial data regarding Merchants and discussed Merchants strategic outlook in light of the current banking industry environment.

On May 26, 2016, the Merchants board held a regularly scheduled meeting in Burlington, Vermont. At this meeting, the Merchants board continued its discussion of Community Bank System's potential interest in a business combination with Merchants and determined that a subset of the Merchants board consisting of Jeffrey Davis, Chairman of the Board of Merchants (who we refer to in this section as Chairman Davis), Michael Furlong, a director of Merchants and Chairman of the Board of Merchants Bank, and Mr. Hesslink, should explore Community Bank System's level of interest.

On June 1, 2016, Chairman Davis, Mr. Furlong and Mr. Hesslink met with Mr. Tryniski and Scott Kingsley, Executive Vice President and Chief Financial Officer of Community Bank System, in Lake George, New York, to discuss a potential business combination between Merchants and Community Bank System. At this meeting, Mr. Tryniski noted Community Bank System's potential interest again at a price in the high \$30's range.

On June 8, 2016, Mr. Hesslink met with Piper Jaffray & Co., financial advisor to Merchants (Piper), to notify them of the potential business combination and discuss the assumptions underlying forecasted financial scenarios. Thereafter, Mr. Hesslink and representatives of Piper met periodically to refine those assumptions.

On June 13, 2016, Merchants and Community Bank System entered into a mutual confidentiality agreement pursuant to which each party agreed to keep confidential certain non-public information about the other party in connection with the consideration of a potential business combination. The confidentiality agreement also included customary standstill obligations of Community Bank System.

Also on June 13, 2016, Merchants entered into a confidentiality agreement with one of its major stockholders, Charles Davis, so that Merchants could obtain his views on a potential business combination with Community Bank System. Charles Davis is a former director of Merchants and the brother of Chairman Davis.

On June 14, 2016, Mr. Hesslink met with Mr. Tryniski and Mr. Kingsley in Lake George, New York, to discuss Merchants' second quarter earnings and other financial matters, as well as the potential structure of the combined company.

On June 15, 2016, Chairman Davis and Mr. Tryniski had a telephone conversation during which they discussed a potential business combination between Merchants and Community Bank System and the strategic advantages of such a combination. During this discussion, Mr. Tryniski noted Community Bank System's potential interest at a price of \$40.00.

On June 27, 2016, the Merchants board held a special meeting in Burlington, Vermont, at which members of management and representatives of Piper and Goodwin Procter LLP, counsel to Merchants (Goodwin Procter), were present. At this meeting, the Merchants board reviewed forecasted financial scenarios for Merchants prepared by management assuming different interest rate environments, as well as the risks, challenges and strategic opportunities

facing the company. The Merchants board also discussed other strategic alternatives available to the company, including a potential business combination transaction with parties other than Community Bank System, additional acquisitions in order to achieve scale, and the potential growth or acquisition of non-interest income businesses. The representatives of Goodwin Procter reviewed the fiduciary duties of the directors in the context of their consideration of a potential business combination. Piper also presented a situational analysis of Merchants, including an overview of the U.S. banking market and preliminary financial analyses with respect to a potential business combination with Community Bank System. The Board discussed with Piper a select number of other banking institutions that may have the capacity to

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pay in the \$40.00 range being proposed by Community Bank System, and concluded that, based on knowledge of those institutions and current industry dynamics, it was unlikely that one of those banking institutions would be interested in engaging in a strategic transaction with Merchants at such a price range at this time.

On July 4, 2016, Chairman Davis and Mr. Hesslink met with Charles Davis in Burlington, Vermont, to obtain Mr. Davis' views on a potential business combination between Merchants and Community Bank System. At this meeting, Mr. Davis indicated his support in exploring a potential transaction with Community Bank System.

On July 7, 2016, the Merchants board held a special meeting in Burlington, Vermont, at which members of management and representatives of Goodwin Procter were present. At this meeting, the representatives of Goodwin Procter again reviewed the fiduciary duties of the directors, and the Merchants board discussed whether it was in the best interests of Merchants stockholders to explore a potential business combination with Community Bank System.

After considering current market conditions and the prospects of Merchants on a stand-alone basis, the Merchants board determined to engage in discussions with Community Bank System regarding a potential business combination between the two companies. The Merchants board also discussed whether it might be advisable to explore a potential strategic transaction with other third parties in addition to Community Bank System. In particular, the Merchants board discussed potential disruptions to Merchants' business, the risk of leaks that might arise from making contact with other parties in the industry (and the potential impact on Merchants' business and employees of such leaks), the potential loss of Community Bank System as a strategic partner if Community Bank System learned of Merchants' exploration of other alternatives, Merchants' own strong knowledge and understanding of its business prospects and value on a stand-alone basis, and the likelihood that Merchants would have already been contacted by another banking institution if it were interested in engaging in strategic discussions with Merchants. Based on the foregoing considerations, the Merchants board concluded not to approach other potential strategic partners. The Merchants board also formed a Special Committee consisting of Jeffrey Davis, Michael Furlong and Geoffrey Hesslink to (1) establish, monitor and direct the process and procedures related to the review of the strategic alternatives of Merchants, (2) invite Community Bank System to submit a written indication of interest, (3) participate in and direct the negotiation of the material terms and conditions of any such transaction, (4) recommend to the Board of Directors the advisability of accepting an indication of interest and negotiating a definitive agreement with respect to any such transaction, and (5) perform any other activities or responsibilities incidental to the foregoing.

Later on July 7, 2016, Chairman Davis and Mr. Hesslink each contacted Mr. Tryniski to report the decision of the Merchants board to engage in discussions with Community Bank System regarding a potential business combination and to invite Community Bank System to submit a written indication of interest.

On July 8, 2016, Mr. Tryniski sent a non-binding proposal to Mr. Hesslink with respect to a potential business combination between Merchants and Community Bank System. The proposal provided for, among other things: (1) a mix of stock and cash consideration, with approximately 65% of the consideration to be paid in the form of Community Bank System common stock in a tax-free exchange; (2) a \$40.00 per share price, consisting of an unspecified fixed exchange ratio for the stock component of the consideration and \$14.00 per share for the cash component of the consideration; (3) one seat on Community Bank System's combined bank/holding company board for an independent director of Merchants to be identified at a later date; (4) a customary termination provision if Community Bank System's stock price were to materially decrease both on an absolute basis and in relation to an appropriate index; (5) a 4% termination fee payable by Merchants; and (6) a requirement that Mr. Hesslink enter into an employment agreement with Community Bank System to serve as its New England Regional President (no specific terms of an employment arrangement were included). The proposal also referenced Community Bank System's commitment to honor the terms of existing employment, change-in-control, termination and retention agreements of Merchants, and the expected payment of severance benefits to displaced employees of Merchants in accordance with Community Bank System's policy and retention bonuses based on development of an integration plan. Community

Bank System's proposal remained subject to the completion of due diligence and the execution of a definitive merger agreement.

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On July 15, 2016, the Merchants board held a special telephonic meeting to approve the engagement of Piper as its financial advisor. In addition, the Merchants board discussed the role members of management should have in connection with the Board's consideration of a business combination with Community Bank System given the references to employment and compensation arrangements with members of management in Community Bank System's July 8 proposal. Following this discussion, the Merchants board reconstituted the Special Committee to include only independent and disinterested directors. The Special Committee thereafter consisted of Chairman Davis, Mr. Furlong and Donald Chase.

On July 19, 2016, the Special Committee held a telephonic meeting at which Mr. Hesslink and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee discussed the proposed terms for a business combination between Merchants and Community Bank System included in Community Bank System's July 8th proposal in light of current market conditions and the prospects of Merchants on a stand-alone basis, the competitive landscape and industry trends. At the conclusion of this discussion, the Special Committee directed Piper to engage in negotiations with Community Bank System's financial advisor, RBC Capital Markets, with respect to: (1) fixing the exchange ratio at one share of Community Bank System common stock for each share of Merchants common stock; (2) increasing the stock component of the merger consideration; (3) providing for Merchants stockholders to have the right to elect the form of consideration that they would like to receive in the transaction; (4) having three seats on Community Bank System's combined bank/holding company board for independent directors of Merchants to be identified at a later date; (5) decreasing the size of the termination fee payable by Merchants to 2.5%; (6) providing for additional severance benefits to displaced employees of Merchants; and (7) continuing the use of the Merchants Bank name. In executive session, the Special Committee also discussed Mr. Hesslink's potential employment agreement with Community Bank System referenced in the proposal.

Also on July 19, 2016, Merchants entered into a formal engagement letter with Piper. Prior to engaging Piper, Merchants confirmed that Piper had no conflicts of interest with respect to Community Bank System.

On July 19 and 20, 2016, representatives of Piper, at the direction of the Special Committee, discussed with representatives of RBC Capital Markets the terms of Community Bank System's July 8 proposal.

On July 20, 2016, the Special Committee held a telephonic meeting at which Mr. Hesslink and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee continued its discussion of Community Bank System's July 8 proposal. The representatives from Piper reported on their recent conversations with RBC Capital Markets regarding the proposal, which had focused on the exchange ratio. Piper reported that RBC had proposed an exchange ratio of 0.95. At the conclusion of this discussion, the Special Committee directed Piper to propose an exchange ratio of 0.9857, which was based on the closing price of the common stock of Community Bank System of \$40.48 per share on July 7th, the day before Community Bank System submitted its indication of interest, which resulted in an implied price for the stock consideration of \$40.00 per share.

From July 20 through 28, 2016, representatives of Piper, at the direction of the Special Committee, further negotiated with representatives of RBC Capital Markets regarding the terms of Community Bank System's July 8 proposal.

On July 26, 2016, Chairman Davis and Mr. Furlong had a telephone conversation with Mr. Tryniski during which they discussed the terms of Community Bank System's July 8 proposal.

On July 28, 2016, the Special Committee held a telephonic meeting at which Mr. Hesslink and representatives of Goodwin Procter were present. At this meeting, the Special Committee continued to discuss Community Bank System's July 8 proposal, including the termination fee payable by Merchants and the number of seats on Community Bank System's combined bank/holding company board to be allocated to Merchants.

On July 29, 2016, Chairman Davis and Mr. Furlong had a telephone conversation with Mr. Tryniski during which they discussed the number of seats on Community Bank System's combined bank/holding company board to be allocated to Merchants.

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Later on July 29, 2016, the Special Committee held a telephonic meeting at which Mr. Hesslink and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee continued to discuss Community Bank System's July 8 proposal and determined to invite Community Bank System to submit a revised proposal reflecting the recent negotiations between the parties and their advisors. Following this meeting, Chairman Davis and Mr. Furlong had a telephone conversation with Mr. Tryniski to report the decision of the Special Committee.

Also on July 29, 2016, a representative of RBC Capital Markets forwarded a revised non-binding proposal to a representative of Piper for delivery to Merchants. The revised letter of intent provided the following changes to Community Bank System's July 8 proposal: (1) approximately 70% of the consideration to be paid in the form of Community Bank System common stock; (2) subject to allocation and proration procedures, the ability of Merchants stockholders to elect between the stock consideration at a fixed exchange ratio of 0.963 of a share of Community Bank System common stock or cash consideration of \$40.00 per share; (3) two to three seats on Community Bank System's combined bank/holding company board for independent directors of Merchants to be identified at a later date; (4) a 3.5% termination fee payable by Merchants; and (5) increased severance benefits for displaced employees of Merchants. Based on the closing price of Community Bank System common stock on July 28, 2016 of \$44.31, the implied value of Community Bank System's offer was \$41.87 per share.

On July 30, 2016, the Special Committee held a telephonic meeting at which Mr. Hesslink and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee discussed the revised terms for a potential business combination included in Community Bank System's July 29 proposal.

On July 31, 2016, Chairman Davis had a telephone conversation with Mr. Tryniski during which they discussed Community Bank System's July 29 proposal.

On August 1, 2016, the Special Committee held a special telephonic meeting at which Mr. Hesslink and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee continued to discuss Community Bank System's July 29 proposal. At the conclusion of this discussion, the Special Committee determined to recommend to the Merchants board that the company proceed with the proposed business combination with Community Bank System.

On August 2, 2016, the Merchants board held a special meeting in Burlington, Vermont, at which members of management and representatives of Piper and Goodwin Procter were present. At this meeting, the Merchants board received an update on discussions with Community Bank System and reviewed the terms of Community Bank System's July 29 proposal, as well as certain preliminary financial analyses prepared by Piper with respect to such proposal. The representatives of Goodwin Procter again reviewed the fiduciary duties of the directors in the context of their consideration of the proposed transaction with Community Bank System. After extensive discussion regarding the proposal, current market conditions, and the prospects and value of Merchants on a stand-alone basis, the Merchants board authorized the Special Committee to engage in due diligence activities with Community Bank System and negotiate a definitive merger agreement with respect to a business combination with Community Bank System on the terms outlined in the July 29th proposal. Following this meeting, Chairman Davis telephoned Mr. Tryniski to inform him of the decision of the Merchants board to proceed forward with Community Bank System regarding a potential business combination.

On August 3, 2016, Merchants countersigned the non-binding letter of intent provided by Community Bank System on July 29th, and thereafter, a representative of RBC Capital Markets on behalf of Community Bank System sent a due diligence request list to Piper.

On August 16, 2016 and throughout the remainder of the process, the Compensation Committee of the Merchants board held meetings at which the Compensation Committee discussed the need to (1) ensure existing contracts with employees were honored by Community Bank System, (2) encourage executives and other employees of Merchants to remain motivated and engaged through the closing of a potential business combination with Community Bank System, and (3) retain such executives and employees if the transaction were not to be completed for any reason. At these meetings, the Compensation Committee authorized

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retention payments to be made to certain employees and executives as described in the section entitled "Interests of Merchants Directors and Executive Officers in the Merger". The Compensation Committee's independent compensation consultant generally participated in these meetings.

On August 19, 2016, Cadwalader, Wickersham & Taft LLP, counsel to Community Bank System ("Cadwalader"), provided an initial draft of the merger agreement and a form of voting agreement to Goodwin Procter.

On August 22, 2016, Merchants provided Community Bank System and its advisors with access to a virtual data room containing business and legal due diligence materials. Thereafter, the parties and their advisors had numerous discussions, and Merchants provided answers to numerous questions posed by Community Bank System and its advisors, regarding the due diligence materials provided by Merchants and related matters.

On August 25, 2016, representatives of Community Bank System met with representatives of Merchants in Lake George, New York to discuss Merchants' business, finances and operations.

On August 29, 2016, Chairman Davis and Mr. Hesslink had a telephone conversation with Mr. Tryniski during which they discussed the potential future organizational structure of the combined company, the process for determining whether members of Merchants' management team would have continuing roles with the combined company, and the implementation of a retention program for employees of Merchants. Thereafter, the parties and their advisors had additional discussions regarding the scope and terms of a retention program for executive and non-executive employees of Merchants.

On September 2, 2016, the Merchants board held a special telephonic meeting at which representatives of Goodwin Procter were present. At this meeting, management provided the Merchants board with an update on the status of due diligence and negotiations related to the proposed business combination with Community Bank System. The Merchants board also discussed executive compensation and employee retention matters.

Later on September 2, 2016, Goodwin Procter provided comments to the initial draft of the merger agreement to Cadwalader. Thereafter, the parties and their advisors had discussions regarding a number of issues in the merger agreement, including: (1) the scope of the respective representations and warranties and operating covenants of Merchants and Community Bank System; (2) the definition of "material adverse effect"; (3) the circumstances in which the Merchants board may change its recommendation to stockholders regarding adoption of the merger agreement; (4) the ability of the Merchants board to respond to unsolicited inquiries following the announcement of the transaction and to terminate the merger agreement to accept a superior proposal; (5) the circumstances in which Merchants would be required to pay a termination fee to Community Bank System or reimburse Community Bank System for its expenses; (6) Community Bank System's obligations with respect to Merchants' employees; (7) Community Bank System's obligations to obtain necessary regulatory approvals; and (8) the parties who would deliver voting agreements to Community Bank System.

On September 7, 2016, a representative of Piper on behalf of Merchants sent a reverse due diligence request list to RBC Capital Markets.

On September 16, 2016, Mr. Hesslink had a telephone conversation with Mr. Tryniski during which they discussed the open business issues with respect to the proposed business combination.

On September 19, 2016, the Special Committee held a telephonic meeting at which Mr. Hesslink and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee received an update on the status of due diligence and negotiations relating to the proposed business combination with Community Bank System. The

Special Committee also discussed the open issues with respect to the merger agreement, the reverse due diligence process and the proposed timing.

Later on September 19, 2016, a representative of RBC Capital Markets contacted a representative of Piper to discuss Community Bank System's due diligence findings and the expected cost savings and restructuring costs related to the transaction, and noted that the total costs to be incurred by Community Bank System were higher than anticipated.

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On September 20, 2016, the Special Committee held a telephonic meeting at which Mr. Hesslink and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee discussed Community Bank System's due diligence findings and the one-time deal costs and potential reductions in Merchants' operating costs on a post-closing basis. At the conclusion of this discussion, the Special Committee authorized management and Piper to work with Community Bank System to better understand these costs. The Special Committee also discussed the reverse due diligence process.

From September 21 through 27, 2016, representatives of Community Bank System and Merchants discussed Community Bank System's due diligence findings and the expected cost savings and restructuring costs. As part of these discussions, RBC Capital Markets, on behalf of Community Bank System, proposed a split in the value of these items between Community Bank System and Merchants stockholders. Piper, at the direction of the Special Committee, informed RBC Capital Markets that Merchants was not open to discussing a potential reduction in the exchange ratio.

On September 29, 2016, Chairman Davis and Mr. Tryniski had a telephone conversation during which they further discussed the expected restructuring costs. During this discussion, Mr. Tryniski agreed that there would be no reduction in the exchange ratio, and Mr. Davis agreed that Merchants would be allocated two (and not three) seats on Community Bank System's combined bank/holding company board.

On September 30, 2016, the Special Committee held a telephonic meeting at which members of management and representatives of Piper and Goodwin Procter were present. At this meeting, the Special Committee discussed the remaining open issues in the merger agreement.

Later on September 30, 2016, the parties and their advisors held a conference call to discuss the remaining open issues in the merger agreement, the reverse due diligence process, timing considerations and employee matters.

On October 5, 2016, representatives of Merchants, Goodwin Procter and Piper met with representatives of Community Bank System and RBC Capital Markets in Lake George, New York, to discuss Community Bank System's business, finances and operations.

On October 7, 2016, Community Bank System provided initial drafts of the employment agreements for the members of Merchants' management team who would be continuing with the combined company, which included Mr. Hesslink, Bruce Bernier, Senior Vice President and Senior Lender of Merchants Bank, and Anita Bourgeois, Senior Vice President and Senior Director, Deposit Growth and Profitability of Merchants Bank. Thereafter, the parties and their counsel negotiated the terms of the employment agreements.

On October 20, 2016, the Merchants board held a special meeting in Essex, Vermont, at which representatives of management, Piper and Goodwin Procter were present. At this meeting, Chairman Davis provided an overview of the negotiation process to date, and the representatives of Goodwin Procter presented the terms of the proposed merger agreement and form of voting agreement. The representatives of Goodwin Procter again discussed the fiduciary duties of the directors in the context of their consideration of the proposed transaction with Community Bank System. Management updated the Board on the status of Community Bank System's due diligence regarding Merchants and the reverse due diligence process. Piper also reviewed with the Merchants board its preliminary analyses of the consideration offered in the proposed transaction from a financial point of view. The Merchants board considered the benefits and risks of the proposed business combination as described in the section entitled "Reasons for the Merger." Management also reviewed the proposed timing for signing and completing the proposed business combination with Community Bank System. Prior to the Merchants board meeting, the Special Committee held a special meeting at the same location to discuss employee retention matters.

On October 20 and 21, 2016, the parties and their counsel negotiated the final terms of the merger.

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On October 22, 2016, the Special Committee and the Merchants board held a joint special meeting in Essex, Vermont, at which representatives of management, Piper and Goodwin Procter were present. At this meeting, Goodwin Procter provided an update on the final negotiations with Community Bank System and its counsel, and Piper reviewed with the Merchants board its final analyses of the consideration offered in the proposed transaction from a financial point of view. Piper then provided its oral opinion, subsequently confirmed in writing, to the effect that, as of October 22, 2016 and subject to the assumptions, qualifications and limitations set forth in the opinion, the consideration to be received pursuant to the merger agreement is fair, from a financial point of view, to the holders of Merchants common stock. Based on the closing price of Community Bank System common stock on October 21, 2016 of \$47.50, the implied value of the merger consideration was \$44.02 per share. After discussion, and upon recommendation of the Special Committee, the Merchants board unanimously adopted resolutions (1) determining that the merger agreement and the transactions contemplated thereby, including the merger, are advisable and in the best interests of the Merchants stockholders, (2) adopting the merger agreement and approving the merger and the other transactions contemplated by the merger agreement, and (3) recommending to Merchants stockholders that they adopt the merger agreement.

Later on October 22, 2016, the merger agreement and voting agreements were executed. Community Bank System also entered into employment agreements with Mr. Hesslink and the other executives of Merchants who would be continuing with the combined company following the closing, and retention agreements with members of Merchants management whose employment would not be continuing.

On October 24, 2016, before the U.S. stock markets opened, Merchants and Community Bank System issued a joint press release announcing the transaction.

Merchants Reasons for the Merger

In the course of its evaluation of the Merger and the Merger Agreement, the Merchants board of directors held numerous meetings and consulted with Merchants senior management as well as its legal counsel and financial advisor. In reaching its decision to approve the Merger and the Merger Agreement and recommend the adoption of the Merger Agreement by its stockholders, the Merchants board considered a number of factors, including, among others, the following:

the Merchants board's and management's knowledge of Merchants' business, operations, properties, assets, financial condition, operating results, historical market prices and prospects, and its and their understanding of Community Bank System's business, operations, properties, assets, financial condition, operating results, historical market prices and prospects, including the information obtained through due diligence;

Merchants' business and financial prospects if it were to remain an independent banking institution, including local economic conditions, the interest rate environment, increasing operating costs resulting from regulatory initiatives and compliance mandates, and the competitive environment for financial institutions generally, all of which would likely impede Merchants' ability to develop the scale necessary to achieve the premium to Merchants' trading price that Community Bank System's offer price presented;

the availability of alternative transactions, including the fact that, in a consolidating industry, institutions with an interest in merging with another institution typically made that interest known; the attractiveness and strategic fit of Community Bank System as a potential merger partner; and the likelihood of an alternative transaction emerging;

the fact that a significant portion of the merger consideration consists of registered shares of Community Bank System common stock and the potential that the value of Community Bank System common stock will increase after the signing of the Merger Agreement;

the ability of Merchants stockholders to elect the form of merger consideration that they wish to receive in the Merger, subject to the proration procedures described in this Proxy Statement/Prospectus;

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the October 22, 2016 financial presentation of Piper (including the assumptions and methodologies underlying the analyses in connection therewith) and the written opinion of Piper delivered to the Merchants board of directors on October 22, 2016, a copy of which is attached to this Proxy Statement/Prospectus as **Annex B**, to the effect that, as of October 22, 2016 and based upon and subject to the assumptions made, procedures followed, matters considered and limitations on the review undertaken in preparing such opinion, the merger consideration was fair, from a financial point of view, to the holders of Merchants common stock, as more fully described under **Opinion of Merchants Financial Advisor** ;

the efforts made to negotiate a Merger Agreement favorable to Merchants and its stockholders and the terms and conditions of the Merger Agreement, including the termination fees and circumstances under which such fees are payable by Merchants;

the ability of Merchants under the terms of the Merger Agreement to negotiate with third parties concerning certain unsolicited competing acquisition proposals if Merchants were to receive such a proposal prior to the adoption of the Merger Agreement by Merchants stockholders, and to terminate the Merger Agreement upon the payment to Community Bank System of a termination fee of \$10.72 million;

the right of Merchants to terminate the Merger Agreement if, subject to Community Bank System's ability to make a compensating adjustment to the stock election consideration, the volume-weighted average trading price of Community Bank System common stock for a specified period prior to the date on which Merchants stockholder approval and all required regulatory approvals have been obtained or waived is less than \$35.77 per share and Community Bank System common stock underperforms a peer group index by more than 20%;

the fact that the Merger is expected to be tax-free to Merchants stockholders to the extent that they receive Community Bank System common stock in exchange for their shares of Merchants common stock; and

the fact that two representatives from the Merchants board will be directors of Community Bank System and Community Bank following the closing of the Merger.

The Merchants board of directors also weighed the factors described above against certain factors and potential risks associated with entering into the Merger Agreement, including, among others, the following:

the fact that the exchange ratio is fixed, which means that Merchants stockholders could be adversely affected by a decrease in the trading price of Community Bank System common stock following the signing of the Merger Agreement;

the possibility of costs and delays resulting from seeking the regulatory approvals necessary to complete the transactions contemplated by the Merger Agreement, the possibility that the Merger may not be completed if such approvals are not obtained, and the potential negative impacts on Merchants, its business and the price of Merchants common stock if such approvals are not obtained;

the fact that the integration of Merchants and Community Bank System may be complex and time consuming and may require substantial resources and effort, and the risk that if the combined bank is not successfully integrated, the anticipated benefits of the Merger may not be realized fully or at all or may take longer to realize than expected, due to the additional regulatory requirements that Community Bank System will be subject to as a result of it having more than \$10 billion in assets following the Merger;

the possibility that the anticipated strategic and other benefits to Merchants and the combined bank following the completion of the Merger will not be realized or will take longer to realize than expected;

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the potential for diversion of management and employee attention and for increased employee attrition during the period prior to the completion of the Merger, and the potential effect of the Merger on Merchants' customers and business relationships;

the restrictions on the conduct of Merchants' business prior to the completion of the Merger, requiring Merchants to conduct its business only in the ordinary course, subject to specific limitations, which could delay or prevent Merchants from undertaking business opportunities that may arise pending completion of the Merger and could negatively impact Merchants' customers and business relationships;

the fact that the Merger Agreement contains certain restrictions on the ability of Merchants to solicit proposals for alternative transactions or engage in discussions regarding such proposals, including the requirement for Merchants to pay Community Bank System a termination fee of \$10.72 million in certain circumstances;

the transaction costs to be incurred by Merchants in connection with the Merger;

the fact that Merchants will lose the autonomy associated with being an independent financial institution; and the various other applicable risks associated with Merchants, Community Bank System and the Merger, including the risks described in Cautionary Statement Regarding Forward-Looking Statements and Risk Factors beginning on page 21 and 15, respectively.

In considering the recommendation of the Merchants board of directors with respect to the proposal to adopt the Merger Agreement, you should be aware that certain of Merchants' directors and executive officers may have interests in the Merger that are different from yours. The Merchants board was aware of and considered these interests, among other matters, in evaluating the Merger Agreement and the transactions contemplated by the Merger Agreement and in recommending that the Merger Agreement be adopted by the Merchants stockholders. Please see Interests of Merchants Directors and Executive Officers in the Merger beginning on page 48.

The foregoing discussion of the information and factors considered by the Merchants board of directors in reaching its conclusions and recommendations is not intended to be exhaustive, but includes the material factors considered by the Merchants board. In view of the wide variety of factors considered in connection with its evaluation of the Merger Agreement and the transactions contemplated by the Merger Agreement, and the complexity of these matters, the Merchants Board did not find it practicable to, and did not attempt to, quantify, rank or otherwise assign any relative or specific weights to the various specific factors considered in reaching its determination and making its recommendation. Moreover, in considering the factors described above and any other factors, individual members of the Merchants Board may have viewed factors differently or given different weight, merit or consideration to different factors. The Merchants board considered all of the foregoing factors as a whole and based its recommendation on the totality of the information presented.

Recommendation of the Merchants Board of Directors

At a meeting held on October 22, 2016, the Merchants board of directors unanimously (i) determined that the Merger Agreement and the Merger are advisable and in the best interests of Merchants and its stockholders, (ii) approved the Merger Agreement and recommended that the Merchants stockholders adopt the Merger Agreement, and (iii) directed that the Merger Agreement be submitted for consideration by the Merchants stockholders at the Merchants special meeting.

THE MERCHANTS BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THE ADOPTION OF THE MERGER AGREEMENT.

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Community Bank System's Reasons for the Merger

In reaching its determination to approve and adopt the Merger Agreement, the board of directors of Community Bank System considered a number of factors, including:

the opportunity to further diversify Community Bank System's geographical markets and customer base as a whole by expanding into Vermont and Western Massachusetts, which is a natural expansion of Community Bank's existing footprint in Upstate New York, and to do so in smaller markets similar to those in which it currently operates; the opportunity to acquire the largest statewide independent bank in Vermont with 11% market share and ranked third in deposits;

the pricing of the transaction absorbs the cost of Community Bank System crossing the \$10 billion in asset threshold and the enhanced regulatory burdens and costs associated with operating a financial holding company of that size; Community Bank System's past experience and success in the acquisition and integration of a bank holding company; the fact that the Merger is expected to be accretive to operating earnings per share of Community Bank System in 2018, exclusive of one-time acquisition related charges and the impact of Community Bank System crossing the \$10 billion in asset threshold;

the potential for the combined company to enhance non-interest income growth by providing enhanced and additional financial products and services to the customers of Merchants in the areas of benefit plan administration, investment management, comprehensive cash management, brokerage services and insurance;

the business, operations, technology, asset quality, competitive position, stock price performance, financial condition and results of operations of Merchants on a historical and prospective basis;

the anticipated operating efficiencies, cost savings and opportunities for revenue enhancements of the combined company following the completion of the Merger, and the likelihood that they would be achieved after the Merger;

the exchange ratio for the Merger and the resulting relative interests of Community Bank System stockholders in the common stock of the combined company, and the amount of total cash consideration to be paid in the Merger;

the fact that the mixture of merger consideration includes a combination of cash and stock in which stockholders would have an election right, but no more than 30% of Merchants common stock would be exchanged for cash;

the deal protection provided by the termination fee of \$10.72 million, payable under certain circumstances in the event of the termination of the Merger Agreement due to a competing offer or certain other reasons;

the intended tax treatment of the Merger; and

the likelihood of receiving all of the regulatory approvals required for the Merger.

Based on these reasons, Community Bank System's board of directors unanimously approved the Merger Agreement and the Merger. This discussion of the factors considered by Community Bank System's board of directors does not list every factor considered by the board but includes all material factors considered by the board. In reaching its determination to approve and adopt the Merger Agreement, the board did not give relative or specific importance to each of the factors listed above, and individual directors may have given differing importance to different factors.

Please note that this explanation of the board's reasoning and all other information presented in this section is forward-looking in nature and, therefore, should be read in light of the factors discussed under the heading "Cautionary Statement Regarding Forward-Looking Statements" beginning on page 21 of this Proxy Statement/Prospectus.

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Opinion of Merchants Financial Advisor

Pursuant to an engagement letter dated July 19, 2016, the Merchants board engaged Piper as financial advisor to Merchants in connection with Merchants' consideration of a possible business combination with Community Bank System. Piper is a nationally recognized investment banking firm with substantial experience in transactions similar to the Merger and is familiar with Merchants and its business. As part of its investment banking business, Piper is routinely engaged in the valuation of financial institutions and their securities in connection with mergers and acquisitions. The Piper written opinion, dated October 22, 2016, is sometimes referred to in this section as the Piper opinion.

Piper acted as financial advisor to Merchants in connection with the proposed transaction and participated in certain of the negotiations leading to the execution of the Merger Agreement. At the meeting of the board of directors of Merchants held on October 22, 2016, Piper delivered to the board of directors its oral opinion, followed by delivery of its written opinion, that, as of such date, and based upon and subject to the various factors, assumptions and limitations set forth in its opinion, the consideration offered in the Merger was fair, from a financial point of view, to the holders of Merchants common stock.

The full text of Piper's written opinion dated October 22, 2016, which sets forth, among other things, the procedures followed, assumptions made, matters considered and qualifications and limitations on the scope of review undertaken in rendering its opinion, is attached as Annex B to this Proxy Statement/Prospectus and is incorporated herein by reference. Piper's opinion speaks only as of the date of the opinion. You are urged to read the opinion carefully and in its entirety. Piper's opinion was addressed to, and provided for the information and benefit of, the Merchants board of directors (in its capacity as such) in connection with its evaluation of the fairness of the merger consideration from a financial point of view, and did not address any other aspects or implications of the Merger. The opinion does not constitute a recommendation to the Merchants board of directors or to any other persons in respect of the Merger, including as to how any holder of Merchants common stock should vote at any stockholders' meeting held in connection with the Merger or take, or not to take, any action in respect of the Merger. Piper's opinion does not address the relative merits of the Merger as compared to any other business or financial strategies that might be available to Merchants, nor does it address the underlying business decision of Merchants to engage in the Merger. The issuance of the Piper opinion was approved by the fairness opinion committee of Piper. The summary of the opinion of Piper set forth below is qualified in its entirety by reference to the full text of the opinion. Piper has consented to the inclusion of this summary of its opinion in this Proxy Statement/Prospectus.

In rendering its opinion, Piper reviewed and analyzed, among other things:

the financial terms contained in a draft of the Merger Agreement dated as of October 22, 2016; certain financial and other data with respect to Merchants and Community Bank System, which was publicly available or made available to Piper by Merchants or Community Bank System; certain forward-looking information relating to Merchants and Community Bank System that was publicly available, as well as that which was furnished to Piper by Merchants or Community Bank System, including the Projections; materials detailing the Merger prepared by Merchants, Community Bank System and their affiliates and by their respective legal and accounting advisors including the estimated amount and timing of the cost savings and related expenses (which included (1) estimated synergies of approximately 22.7% of Merchants' non-interest expense base with 75% phased-in 2017 and 100% in 2018 and going forward and (2) an estimated \$10.0 million pre-tax annual negative impact to income for Community Bank System due to \$10 billion asset threshold beginning in the second half of 2018) and purchase accounting adjustments expected to result from the Merger (which included (1) 0.89%

gross credit mark (\$12.4 million or 1.0x reserves) on the acquired loan portfolio and (2) core deposit intangible assumed to equal 1.5% of Merchants' core deposits (deposits less all time deposits)) (which are collectively referred to in this section as the Synergies);

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current and historical reported prices and trading activity of Merchants and Community Bank System and similar information for certain other publicly traded companies deemed by Piper to be comparable to Merchants and Community Bank System;
the financial performance of Merchants and Community Bank System with that of certain other publicly traded companies that Piper deemed relevant;
certain financial analyses Piper performed for Merchants and Community Bank System on a pro forma combined basis giving effect to the Merger based on assumptions relating to the Synergies;
the merger consideration relative to the historical trading price of Merchants and Merchants tangible book value, core deposits (deposits less all jumbo time deposits and brokered deposits) and last twelve months earnings as of June 30, 2016 as well as analyst estimated earnings for 2017;
the current market environment generally and the commercial banking environment in particular;
the financial terms, to the extent publicly available, of certain business combination transactions in the depository banking industry that Piper deemed relevant; and
such other analyses, examinations and inquiries and considered such other financial, economic and market criteria as Piper deemed necessary in arriving at its opinion.

Piper also held several discussions with certain members of senior management and representatives of both Merchants and Community Bank System with respect to certain aspects of the Merger, and the past and current business operations of Merchants and Community Bank System, the financial condition and future prospects and operations of Merchants and Community Bank System, the effects of the Merger on the financial condition and future prospects of Community Bank System, and certain other matters Piper believed necessary or appropriate to its inquiry.

In arriving at its opinion, Piper relied upon and assumed, without assuming liability or responsibility for independent verification, the accuracy and completeness of all information that was publicly available or was furnished, or otherwise made available to, or discussed with or reviewed by Piper. Piper further relied upon the assurances of the management of Merchants and Community Bank System that the financial information provided has been prepared on a reasonable basis in accordance with industry practice, and that they are not aware of any information or facts that would make any information provided to Piper incomplete or misleading. Without limiting the generality of the foregoing, Piper assumed that with respect to financial forecasts, estimates and other forward-looking information (including the Synergies) reviewed by Piper, that such information was reasonably prepared based on assumptions reflecting the best currently available estimates and judgments of the management of Merchants and Community Bank System as to the expected future results of operations and financial condition of Merchants and Community Bank System, respectively, to which such financial forecasts, estimates and other forward-looking information (including the Synergies) relate and Piper assumed that such results would be achieved. Piper expressed no opinion as to any such financial forecasts, estimates or forward-looking information (including the Synergies) or the assumptions on which they were based. Piper further assumed that the Merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, for United States federal income tax purposes. Piper also expressed no opinion as to any of the legal, accounting and tax matters relating to the Merger and any other transactions contemplated in connection therewith and with the consent of Merchants relied, on the advice of the outside legal counsel and the independent accountants to Merchants, and on the assumptions of the management of Merchants and Community Bank System, as to all accounting, legal, tax and financial reporting matters with respect to Merchants and Community Bank System and the Merger Agreement.

In arriving at its opinion, Piper assumed that the executed Merger Agreement would be in all material respects identical to the last draft reviewed by it. Piper relied upon and assumed, without independent verification, that:

the representations and warranties of all parties to the Merger Agreement and all other related documents and instruments that are referred to therein are true and correct;

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each party to such agreements will fully and timely perform all of the covenants and agreements required to be performed by such party;
the Merger will be consummated pursuant to the terms of the Merger Agreement without amendments thereto; and all conditions to the consummation of the Merger will be satisfied without waiver by any party of any conditions or obligations thereunder.

Additionally, Piper assumed that all the necessary regulatory approvals and consents required for the Merger will be obtained in a manner that will not adversely affect Merchants and Community Bank System or the contemplated benefits of the Merger.

For purposes of rendering its opinion, Piper did not perform any appraisals or valuations of any specific assets or liabilities (fixed, contingent, derivative, off-balance sheet, or other) of Merchants or Community Bank System, and was not furnished or provided with any such appraisals or valuations, and did not evaluate the solvency of Merchants or Community Bank System under any state or federal law relating to bankruptcy, insolvency or similar matters. Accordingly, Piper expressed no opinion regarding the liquidation value of Merchants, Community Bank System or any other entity. Piper assumed that there has been no material change in the respective assets, financial condition, results of operations, business or prospects of Merchants or Community Bank System since the date of the most recent financial data made available to Piper. Piper also assumed in all respects material to its analysis that Merchants and Community Bank System would remain as a going concern for all periods relevant to its analysis. Without limiting the generality of the foregoing, Piper did not conduct a review of:

any individual credit files of Merchants or Community Bank System, nor evaluate the adequacy of the loan or lease reserves of Merchants or Community Bank System;
any credit mark that may be taken in connection with the Merger, nor evaluate the adequacy of any contemplated credit mark to be so taken; or
the collectability of any asset or the future performance of any loan of Merchants or Community Bank System.

Piper also assumed, with Merchants' consent, that the respective allowances for loan and lease losses for both Merchants and Community Bank System and the credit mark are adequate to cover any losses and will be adequate on a pro forma basis for the combined company. Accordingly, Piper expressed no opinion with respect to these matters.

In addition, Piper did not make any independent analysis of any pending or threatened litigation, regulatory action, possible unasserted claims or other contingent liabilities to which Merchants or Community Bank System is a party or may be subject, and at the direction of Merchants and with its consent, Piper's opinion makes no assumption concerning, and therefore does not consider, the possible assertion of claims, outcomes or damages arising out of any such matters. Piper also assumed that neither Merchants nor Community Bank System is party to any material pending transaction, including without limitation any financing, recapitalization, acquisition or merger, divestiture or spin-off, other than the Merger and the merger of the principal banking subsidiaries of Merchants and Community Bank System contemplated by the agreement.

The Piper opinion is necessarily based on economic, market and other conditions and upon the information made available to Piper and facts and circumstances as they exist and are subject to evaluation as of the date of the Piper opinion. It should be understood that events occurring after the date of the Piper opinion could materially affect the assumptions used in preparing the Piper opinion. Further, Piper expressed no opinion as to the price at which shares of the common stock of Merchants or Community Bank System may trade following announcement of the Merger or at any future time.

The Piper opinion addresses solely the fairness, from a financial point of view, to holders of Merchants common stock of the proposed merger consideration set forth in the Merger Agreement and does not address any other terms or agreement relating to the Merger or any other terms of the Merger Agreement. Piper was

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not requested to opine as to, and the Piper opinion does not address: (1) the basic business decision to proceed with or effect the Merger; (2) the merits of the Merger relative to any alternative transaction or business strategy that may be available to Merchants; (3) Community Bank System's ability to fund the cash portion of the merger consideration; (4) any other terms contemplated by the Merger Agreement; or (5) the fairness of the Merger, or any consideration received in connection therewith by, the holders of any other class of securities, any creditor or other constituency of Merchants. Furthermore, Piper expressed no opinion with respect to the amount or nature of compensation to any officer, director or employee of any party to the Merger, or any class of such persons, relative to the merger consideration to be received by holders of Merchants common stock in the Merger or with respect to the fairness of any such compensation, including whether such payments are reasonable in the context of the Merger.

In performing its analyses, Piper made numerous assumptions with respect to industry performance, general business, economic, market and financial conditions and other matters, which are beyond the control of Piper, Merchants and Community Bank System. Any estimates contained in the analyses performed by Piper are not necessarily indicative of actual values or future results, which may be more or less favorable than suggested by these analyses. Additionally, estimates of the value of businesses or securities do not purport to be appraisals or to reflect the prices at which such businesses or securities might actually be sold. Accordingly, these analyses and estimates are inherently subject to substantial uncertainty. In addition, the Piper opinion was among several factors taken into consideration by the Merchants board in making its determination to approve the Merger Agreement. The type and amount of consideration payable in the Merger were determined solely through negotiation between Merchants and Community Bank System, and the decision to enter into the Merger Agreement was solely that of the Merchants board.

Piper's opinion was necessarily based upon conditions as they existed and could be evaluated on October 22, 2016, the date of such opinion, and the information made available to Piper through such date. Developments subsequent to the date of Piper's opinion may have affected, and may affect, the conclusion reached in Piper's opinion, and Piper did not and does not have an obligation to update, revise or reaffirm its opinion.

The following is a summary of the material financial analyses performed and presented by Piper to the Merchants board on October 22, 2016 in connection with its fairness opinion. Each analysis was provided to the Merchants board of directors. The following summary, however, does not purport to be a complete description of all the analyses performed and reviewed by Piper underlying the Piper opinion or the presentation made by Piper to the Merchants board on October 22, 2016, but summarizes the material analyses performed and presented in connection with such opinion. The preparation of a fairness opinion is a complex analytic process involving various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances. A fairness opinion is thus not susceptible to partial analysis or summary description. In arriving at its opinion, Piper did not attribute any particular weight to any analysis or factor that it considered, but rather made qualitative judgments as to the significance and relevance of each analysis and factor.

The financial analyses summarized below include information presented in tabular format. The tables alone do not constitute a complete description of the financial analyses. Accordingly, Piper believes that its analyses and the summary of its analyses must be considered as a whole and that selecting portions of its analyses and factors or focusing on the information presented below in tabular format, without considering all analyses and factors or the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a potentially misleading or incomplete view of the process underlying its analyses and opinion. Also no company or transaction used in Piper's analysis for purposes of comparison is identical to Merchants and Community Bank System or the Merger. Accordingly, an analysis of the results of the comparisons is not mathematical; rather, it involves complex considerations and judgments about differences in the companies and transactions to which Merchants and Community Bank System and the Merger were compared and other factors that could affect the public trading value or transaction value of the companies to which they are being compared. Except as otherwise noted, the

following quantitative information, to the extent that it is based on market data, is based on market data that existed on or before October 22, 2016 (the date of the Piper opinion), and is not necessarily indicative of current market conditions.

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Summary of Proposal. Pursuant to the terms of the Merger Agreement, at the effective time of the Merger, each share of Merchants common stock will be converted, at the election of the holder, into the right to receive the following consideration: (i) the combination of \$12.00 in cash and 0.6741 shares of Community Bank System common stock; (ii) 0.9630 shares of Community Bank System common stock; or (iii) \$40.00 in cash, subject to an allocation process intended to result in approximately 70% of the shares of Merchants common stock being exchanged for shares of Community Bank System. Based on Community Bank System's closing price on October 21, 2016 of \$47.50, the merger consideration was equivalent to a price of \$44.02 per share of Merchants common stock. Based on this deemed value per share to Merchants stockholders and based on an aggregate of 6,883,644 shares of Merchants common stock outstanding, 27,020 options outstanding with a weighted average exercise price of \$22.49 per share and 77,999 warrants outstanding with a weighted average exercise price of \$29.81, the aggregate merger consideration to holders of Merchants common stock, options and warrants was approximately \$304.7 million.

Selected Companies Analysis. Using publicly available information, Piper compared the financial performance, financial condition, and market performance of Merchants to seventeen selected major exchange traded bank holding companies and thrifts headquartered in the New England and Mid-Atlantic with total assets between \$1.0 billion and \$3.0 billion and last twelve months return on average assets between 0.50% and 1.00%. The companies included in this group were:

Company	Ticker	State
CNB Financial Corporation	CCNE	PA
Enterprise Bancorp, Inc.	EBTC	MA
BSB Bancorp, Inc.	BLMT	MA
Peoples Financial Services Corp.	PFIS	PA
ESSA Bancorp, Inc.	ESSA	PA
Chemung Financial Corporation	CHMG	NY
Old Line Bancshares, Inc.	OLBK	MD
Bankwell Financial Group, Inc.	BWFG	CT
Orrstown Financial Services, Inc.	ORRF	PA
Codorus Valley Bancorp, Inc.	CVLY	PA
First United Corporation	FUNC	MD
Community Financial Corporation	TCFC	MD
ACNB Corporation	ACNB	PA
Shore Bancshares, Inc.	SHBI	MD
1 st Constitution Bancorp	FCCY	NJ
Evans Bancorp, Inc.	EVBN	NY
Mid Penn Bancorp, Inc.	MPB	PA

Using publicly available information, Piper compared the financial performance, financial condition, and market performance of Community Bank System to a regional peer group and a nationwide high performing peer group. The regional peer group was based on eight selected publicly traded bank holding companies and thrifts headquartered in the New England and Mid-Atlantic regions of the United States with total assets between \$5.0 billion and \$12.0 billion and last twelve months return on average assets greater than 0.90%. The companies included in this regional peer group were:

Company	Ticker	State
Provident Financial Services, Inc.	PFS	NJ
NBT Bancorp Inc.	NBTB	NY

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Independent Bank Corp.	INDB	MA
Eagle Bancorp, Inc.	EGBN	MD
S&T Bancorp, Inc.	STBA	PA
Brookline Bancorp, Inc.	BRKL	MA
Tompkins Financial Corporation	TMP	NY
WSFS Financial Corporation	WSFS	DE

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The nationwide high performing peer group was based on ten selected publicly traded bank holding companies and thrifts headquartered in the United States with total assets between \$5.0 billion and \$12.0 billion, last twelve months return on average assets greater than 1.10% and non-interest income to total revenue greater than 20%. The companies included in this nationwide high performing peer group were:

Company	Ticker	State
Pinnacle Financial Partners, Inc.	PNFP	TN
Columbia Banking System, Inc.	COLB	WA
Glacier Bancorp, Inc.	GBCI	MT
South State Corporation	SSB	SC
Simmons First National Corporation	SFNC	AR
BofI Holding, Inc.	BOFI	CA
First Financial Bankshares, Inc.	FFIN	TX
Ameris Bancorp	ABCB	GA
WSFS Financial Corporation	WSFS	DE
Westamerica Bancorporation	WABC	CA

To perform this analysis, Piper used financial information as of the twelve-month period ended September 30, 2016 (or as of the most recently available quarter). Market price information was as of October 21, 2016. Earnings estimates for 2017 for Merchants, Community Bank System and other selected companies were taken from SNL Financial, a nationally recognized earnings estimate consolidator.

Piper's analysis showed the following concerning Merchants and Community Bank System's market performance:

	Merchants Group Minimum	Merchants Group 25 th Percentile	Merchants Group Median	Merchants Group Mean	Merchants Group 75 th Percentile	Merchants Group Maximum	
Stock Price/Tangible Book Value per Share	152.4 %	88.8 %	112.0 %	121.7 %	127.7 %	140.7 %	165.5 %
Stock Price/Last Twelve Months EPS	15.6x	7.7x	13.8x	15.8x	15.7x	17.1x	23.0x
Stock Price/2017 Est. EPS	13.4x	11.3x	12.8x	13.0x	13.7x	14.0x	18.8x
Dividend Yield	3.4 %	0.0 %	1.2 %	1.8 %	2.0 %	2.7 %	3.6 %

Using the range of multiples representing the 25th and 75th percentiles, the analysis indicated an approximate implied per share equity value range for Merchants of \$24.15 to \$35.91.

	Community Bank System Regional Group Minimum	Community Bank System Regional Group 25 th Percentile	Community Bank System Regional Group Median	Community Bank System Regional Group Mean	Community Bank System Regional Group 75 th Percentile	Community Bank System Regional Group Maximum	
Stock Price/Tangible Book Value per Share	278.5 %	164.7 %	186.3 %	215.3 %	211.2 %	232.3 %	265.0 %

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Stock Price/Last Twelve Months EPS	21.6x	14.1x	16.8x	17.4x	17.4x	18.1x	20.9x
Stock Price/2017 Est. EPS	19.9x	13.8x	14.7x	16.2x	16.1x	17.3x	18.8x
Dividend Yield	2.7 %	0.0 %	1.8 %	2.5 %	2.1 %	2.8 %	3.4 %

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Using the range of multiples representing the 50th and 100th percentiles for CBU s Regional Peer Group, the analysis indicated an approximate implied per share equity value range of \$36.73 to \$45.99.

	Community Bank System	Community Bank System Nationwide Group Minimum	Community Bank System Nationwide Group 25 th Percentile	Community Bank System Nationwide Group Median	Community Bank System Nationwide Group Mean	Community Bank System Nationwide Group 75 th Percentile	Community Bank System Nationwide Group Maximum
Stock Price/Tangible Book Value per Share	278.5 %	200.3 %	212.1 %	227.9 %	241.7 %	257.8 %	328.1 %
Stock Price/Last Twelve Months EPS	21.6x	11.9x	17.2x	18.0x	18.0x	18.6x	23.0x
Stock Price/2017 Est. EPS	19.9x	10.5x	14.2x	15.5x	16.0x	16.7x	21.7x
Dividend Yield	2.7 %	0.0 %	1.1 %	1.8 %	1.7 %	2.4 %	3.2 %

Using the range of multiples representing the 50th and 100th percentiles for CBU s Nationwide Peer Group, the analysis indicated an approximate implied per share equity value range for CBU of \$37.06 to \$70.58.

Comparable Transaction Analysis. Piper reviewed certain publicly available information related to twelve selected acquisitions of banks and bank holding companies as well as thrifts and thrift holding companies with headquarters in the New England and Mid-Atlantic regions of the United States announced after January 1, 2013, where transaction value was available and the buyer was a bank or bank holding company or a thrift or thrift holding company, the seller had assets between \$1.0 billion and \$3.0 billion and last twelve months return on average assets between 0.25% and 1.25%. The transactions included in the group were:

Acquiror	Acquiree
OceanFirst Financial Corp.	Ocean Shore Holding Co.
People's United Financial, Inc.	Suffolk Bancorp
Bar Harbor Bankshares	Lake Sunapee Bank Group
Investors Bancorp, Inc.	Bank of Princeton
OceanFirst Financial Corp.	Cape Bancorp, Inc.
Univest Corporation of Pennsylvania	Fox Chase Bancorp, Inc.
United Bankshares, Inc.	Bank of Georgetown
WesBanco, Inc.	ESB Financial Corporation
Bank of the Ozarks, Inc.	Interinvest Bancshares Corporation
Center Bancorp, Inc.	ConnectOne Bancorp, Inc.
Rockville Financial, Inc.	United Financial Bancorp, Inc.
Provident New York Bancorp	Sterling Bancorp

Transaction multiples for the Merger were based on an offer price of \$44.02 per share for Merchants based on Community Bank System s October 21, 2016 closing price of \$47.50. For each precedent transaction, Piper derived and compared, among other things, the implied ratio of price per common share paid for the acquired company to:

tangible book value per share of the acquired company based on the latest financial statements of the company available prior to the announcement of the acquisition;

tangible equity premium to core deposits (total deposits less time deposits greater than \$100,000 and brokered deposits) based on the latest financial statements of the company available prior to the announcement of the acquisition;

the last twelve months earnings per share based on the latest financial statements of the company available prior to the announcement of the acquisition; and

analyst estimated earnings per share for the forward year at the announcement of the acquisition.

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In addition, Piper derived and compared the price per share paid for the acquired company as a percentage of the closing price of the acquired company one day prior to the announcement of the acquisition.

The results of the analysis are set forth in the following table:

Transaction Price to:	Merchants/ Bank System Merger	Comparable Transactions Minimum	Comparable Transactions 25 th Percentile	Comparable Transactions Median	Comparable Transactions Mean	Comparable Transactions 75 th Percentile	Comparable Transactions Maximum
Tangible Book Value	204.2 %	110.6 %	138.0 %	157.6 %	161.7 %	183.5 %	217.9 %
Core Deposit Premium	11.3 %	2.8 %	5.6 %	8.7 %	9.9 %	12.5 %	20.5 %
LTM Earnings Per Share	21.0x	13.1x	16.4x	19.8x	19.1x	21.6x	27.6x
FWD Yr Est. Earnings Per Share	17.9x	14.0x	15.0x	17.8x	17.9x	19.3x	24.3x
One-Day Market Premium	34.0 %	10.9 %	15.0 %	17.5 %	23.5 %	29.3 %	49.1 %

Using the range of multiples representing the 25th and 75th percentiles, the analysis indicated an approximate implied per share equity value range for Merchants of \$29.75 to \$47.40 based on the selected transactions.

Discounted Cash Flow Analysis. Piper performed a discounted cash flow analysis to estimate a range of the present values of after-tax cash flows that Merchants could provide to equity holders through 2020 on a stand-alone basis. In performing this analysis, Piper used the Projections to derive projected after-tax cash flows. The analysis assumed discount rates ranging from 11.0% to 13.0%, which were assumed deviations, both up and down, as selected by Piper based on the Merchants discount rate of 11.8% as determined by Piper. The range of values for the discounted cash flow analysis was determined by adding (1) the present value of projected cash flows to Merchants stockholders from fiscal years 2016 to 2020 and (2) the present value of the terminal value of Merchants common stock. In determining cash flows available to Merchants stockholders, Piper assumed that Merchants would maintain a tangible common equity to tangible asset ratio of 7.00% and would retain sufficient earnings to maintain these levels. Any earnings in excess of what would need to be retained were assumed to be distributed as dividends to Merchants stockholders. In calculating the terminal value of Merchants, Piper applied multiples ranging from 13.0 times to 15.0 times fiscal year 2020 estimated earnings. These multiples were selected based on a review of trading multiples of common stocks of the selected bank holding companies headquartered in the New England and Mid-Atlantic regions of the United States with total assets between \$1.0 billion and \$3.0 billion specified above. Piper also assumed a pre-tax cost of cash of 1.50% and a marginal tax rate of 35.0%. This resulted in a range of values of Merchants from \$29.71 to \$35.34 per share.

Piper also performed a discounted cash flow analysis to estimate a range of the present values of after-tax cash flows that Community Bank System could provide to equity holders through fiscal year 2020 on a stand-alone basis and on a pro forma basis, which included the Synergies and the impact of crossing the \$10 billion threshold. In performing this analysis, Piper used publicly available earnings estimates by research analysts covering Community Bank System, which were discussed with senior management of Community Bank System, for fiscal years 2016 (EPS of \$2.32) and 2017 (EPS of \$2.40), and with respect to the fiscal years 2018 through 2020 applied an earnings growth rate of 5.0% to derive projected after-tax cash flows. The analysis assumed discount rates ranging from 10.0% to 12.0%, which were assumed deviations, both up and down, as selected by Piper based on the Community Bank System discount rate of 11.3% as determined by Piper. The analysis also assumed asset growth based on analyst estimates through 2017 and 3.0% growth thereafter. The range of values for the discounted cash flow analysis was determined by adding (1) the present value of projected cash flows to Community Bank System's stockholders from fiscal years 2016 to 2020 and (2) the present value of the terminal value of Community Bank System's common stock. In determining cash flows

available to stockholders, Piper assumed that Community Bank System would maintain a tangible common equity to tangible asset ratio of 7.00% and would retain sufficient earnings to maintain these levels. Any earnings in excess of what would need to be retained were assumed to be distributed as dividends to Community Bank System stockholders. In calculating the terminal value of

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Community Bank System, Piper applied multiples ranging from 17.0 times to 19.0 times fiscal year 2020 estimated earnings. These multiples were selected based on a review of trading multiples of the eight publicly traded bank holding companies headquartered in the Mid-Atlantic and New England regions of the United States with total assets between \$5.0 billion and \$12.0 billion specified above. Piper also assumed a pre-tax cost of cash of 1.50% and a marginal tax rate of 35.0%. This resulted in a range of values of Community Bank System on a stand-alone basis from \$41.72 to \$48.43 per share and on a pro forma basis from \$41.60 to \$48.58 per share.

Piper stated that the discounted cash flow present value analysis is a widely used valuation methodology but noted that it relies on numerous assumptions, including asset and earnings growth rates, terminal values and discount rates. The analysis did not purport to be indicative of the actual values or expected values of Merchants and Community Bank System.

Financial Impact Analysis. Piper performed pro forma merger analyses that combined projected income statement and balance sheet information of Merchants and Community Bank System. Assumptions regarding the Synergies were used to calculate the financial impact that the Merger would have on certain projected financial results of Community Bank System. In the course of this analysis, Piper used the Projections for Merchants and used assumptions provided by Community Bank System's management for the Synergies. For Community Bank System, Piper used publicly available earnings estimates by research analysts covering Community Bank System for 2016 and 2017 and applied an earnings growth rate of 5.0% thereafter. This analysis indicated that the Merger is expected to be accretive to Community Bank System's estimated earnings per share in 2017 and 2018. The analysis also indicated that the Merger is expected to be dilutive to tangible book value per share for Community Bank System with an earnback (using the Crossover method) of 4.7 years including the impact of crossing the \$10 billion asset threshold, 3.3 years excluding the impact of crossing the \$10 billion asset threshold and dilutive to Community Bank System's tangible common equity to tangible assets ratio, leverage ratio and total risk-based capital ratio. For all of the above analyses, the actual results achieved by Community Bank System following the Merger will vary from the projected results, and the variations may be material.

Other Analyses. Among other things, Piper also reviewed earnings estimates, balance sheet composition and other financial data for Merchants and Community Bank System. With respect to Merchants' public price, Piper reviewed the public price targets of the three research analysts covering Merchants as provided by SNL Financial, a nationally recognized research price target consolidator, of which the mean was \$33.50. With respect to Community Bank System's public price, Piper reviewed the public price targets of the five research analysts covering Community Bank System as provided by SNL, of which the mean was \$42.80. Piper also reviewed the historical trading performances of shares of Merchants and Community Bank System common stock during the 52-week period ended October 21, 2016. Merchants common stock traded as low as \$27.21 per share and as high as \$33.99 per share, and the closing price of Merchants common stock on October 21, 2016 was \$32.85 per share. Community Bank System common stock traded as low as \$34.47 per share and as high as \$48.67 per share, and the closing price of Community Bank System common stock on October 21, 2016 was \$47.50 per share.

Piper's Compensation and Other Relationships. Merchants and Piper entered into an engagement letter dated July 19, 2016 relating to the services to be provided by Piper in connection with the Merger. Pursuant to the engagement letter, Merchants agreed to pay Piper (a) a fee of \$250,000 upon the delivery to the Merchants board of the written Piper opinion, which fee will be credited against the transaction fee; and (b) contingent upon closing of the Merger, a transaction fee of \$1.9 million. Pursuant to the Piper engagement letter, Merchants also agreed to reimburse Piper for reasonable out-of-pocket expenses and disbursements incurred in connection with its retention up to \$25,000 without Merchants' prior written consent. Merchants has also agreed to indemnify Piper against certain liabilities, including liabilities under the federal securities laws, arising out of its engagement.

Other than Piper's engagement by Merchants in connection with the Merger, Piper has not provided any other material investment banking or financial advisory services to Merchants, Community Bank System or their affiliates during the past two years; however, Piper may do so in the future. In the ordinary course of

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Piper's business as a broker-dealer, Piper may, from time to time, purchase securities from and sell securities to Merchants, Community Bank System or their affiliates.

Certain Prospective Financial Information

Merchants does not, as a matter of course, publicly disclose forecasts or projections of its expected future financial performance, earnings or other results because of, among other things, the inherent difficulty of predicting financial performance for future periods and the likelihood that the underlying assumptions and estimates may not be realized.

However, Merchants is including in this Proxy Statement/Prospectus certain unaudited prospective financial information that was prepared based on publicly available earnings estimates (the Projections). The Projections were discussed with Piper and used by Piper in connection with its financial analyses and opinion to the Merchants board of directors as described above under the heading Opinion of Merchants Financial Advisor. The Projections also were provided to the Merchants board in its consideration of the Merger.

The Projections were not prepared with a view toward public disclosure and, accordingly, do not necessarily comply with published guidelines of the SEC or established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information or generally accepted accounting principles. Merchants' independent registered public accounting firm, which is listed as an expert in the section entitled Experts, or any other independent accountants, did not compile, examine, audit, or perform any procedures with respect to such prospective financial information, and has not expressed any opinion or any other form of assurance on this information or its achievability.

The Projections, while presented with numerical specificity, necessarily were based on numerous variables and assumptions that are inherently uncertain and many of which are beyond the control of Merchants' management. Given that the Projections cover multiple years, by their nature, they become subject to greater uncertainty with each successive year. The assumptions upon which the Projections were based necessarily involve judgments with respect to, among other things, future economic, market, competitive and regulatory conditions, all of which are difficult or impossible to predict and many of which are beyond Merchants' control. Important factors that may affect actual results and the achievability of the Projections include, but are not limited to, the risks and uncertainties described in Merchants' annual report on Form 10-K for the fiscal year ended December 31, 2015, subsequent quarterly reports on Form 10-Q and current reports on Form 8-K. See Where You Can Find More Information beginning on page 104 of this Proxy Statement/Prospectus.

The Projections also reflect assumptions that are subject to change and are susceptible to multiple interpretations and periodic revisions based on actual results, revised prospects for Merchants' business, changes in general business or economic conditions, or any other transaction or event that has occurred or that may occur and that was not anticipated when the Projections were prepared. In addition, the Projections do not take into account any circumstances, transactions or events occurring after the dates on which the Projections were prepared. Accordingly, actual results will differ, and may differ materially, from those contained in the Projections. There can be no assurance that the financial results in the Projections will be realized, or that future actual financial results will not materially vary from those in the Projections.

The inclusion of a summary of the Projections should not be regarded as an indication that Community Bank System or Merchants or any of their respective affiliates, officers, directors, advisors or other representatives consider the Projections to be predictive of actual future events, and the Projections should not be relied upon as such. None of Community Bank System or Merchants or any of their respective affiliates, officers, directors, advisors or other representatives gives any stockholder of Merchants or any other person any assurance that actual results will not differ

materially from the Projections, and, except as otherwise required by law, Community Bank System, Merchants and their respective affiliates undertake no obligation to update or otherwise revise or reconcile the Projections to reflect circumstances existing after the dates on which the Projections were prepared or to reflect the occurrence of future events, even in the event that any or all of the assumptions and estimates underlying the Projections are shown to be in error.

In light of the foregoing factors and the uncertainties inherent in the Projections, Merchants stockholders are cautioned not to place undue, if any, reliance on such Projections.

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The following table presents a summary of the Projections, which has been included solely to give the Merchants stockholders access to certain prospective financial information that was made available to the Merchants board and used by Piper, and is not included in this Proxy Statement/Prospectus to influence any decision of Merchants stockholders as to whether to vote to adopt the Merger Agreement or for any other purpose. The Projections are based on publicly available earnings estimates by research analysts covering Merchants through 2017, with an earnings growth rate of 5.0% applied to derive fiscal years 2018 through 2020. The projected financial data provided in this table has not been updated to reflect Merchants' current views of its future financial performance, and should not be treated as guidance with respect to projected results for 2016 or any other period.

<i>(in millions, except per share amounts)</i>	2016P ⁽¹⁾	2017P	2018P	2019P	2020P
Net Income	\$ 16.1	\$ 16.9	\$ 17.8	\$ 18.7	\$ 19.6
Earnings Per Diluted Share	\$ 2.34	\$ 2.46	\$ 2.58	\$ 2.71	\$ 2.85

(1) Based on actual results for the first six months of calendar year 2016, and publicly available earnings estimates of research analysts for the remainder of the calendar year.

The Projections were used to derive projected after-tax cash flows based on assumptions provided by management, including (1) asset growth based on analyst estimates through 2017 and 4.0% asset growth thereafter, (2) a tangible common equity to tangible assets threshold of 7.0%, (3) pre-tax cost of cash of 1.5%, and (4) a marginal tax rate of 35.0%. Based on these assumptions, the projected after-tax cash flows were: \$5.8 million for the second half of 2016; \$11.8 million in 2017; \$12.3 million in 2018; \$12.8 million in 2019; and \$13.2 million in 2020. This information was not prepared with a view toward public disclosure, and actual results may differ materially from these projected amounts.

Stockholder Support Agreements with Directors and Another Principal Stockholder of Merchants

Community Bank System has entered into a stockholder support agreement with each director of Merchants and another principal stockholder of Merchants with voting power with respect to an aggregate of 739,146 shares of Merchants common stock, or approximately 11% of the shares of Merchants common stock outstanding as of the record date. Pursuant to the agreements, each director and the principal stockholder of Merchants have agreed to vote FOR the adoption of the Merger Agreement all of the shares of Merchants common stock that they are entitled to vote.

Interests of Merchants Directors and Executive Officers in the Merger

In considering the recommendation of the Merchants board of directors with respect to its approval of the Merger Agreement, Merchants stockholders should be aware that certain of Merchants' directors and executive officers have interests in the Merger that are different from, or in addition to, those of Merchants stockholders generally. These interests may create potential conflicts of interest. The Merchants board of directors was aware of and considered these interests, among other matters, in reaching its decision to approve, and declare advisable, the Merger Agreement, the Merger and the other transactions contemplated by the Merger Agreement. The material interests are summarized below.

Effect of the Merger Agreement on Equity Awards

In connection with the Merger, the Merchants' equity awards held by Merchants' directors and executive officers will be treated the same as all outstanding Merchants' equity awards, except as noted below under the header titled *Equity Awards of Certain Directors and Executive Officers*.

Cash Payment for Outstanding Merchants Stock Options. Consistent with the terms of Merchants' 2008 Stock Incentive Plan, the Merger Agreement provides that, at the effective time of the Merger, each Merchants stock option outstanding and unexercised immediately prior to the effective time of the Merger, whether or not vested or exercisable, will be cancelled and automatically converted into the right to receive a cash amount equal to the aggregate number of shares of Merchants common stock subject to such option *multiplied by* the excess of the value of the mixed election consideration over the exercise price of such option.

Vesting of Merchants Restricted Stock Awards. Consistent with the terms of Merchants' 2008 Stock Incentive Plan, the Merger Agreement provides that, at the effective time of the Merger, each share of

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Merchants common stock subject to vesting or forfeiture restrictions and granted under any Merchants benefit plan that is outstanding immediately prior to the effective time, whether or not vested, will automatically vest in full, and any restrictions thereon will lapse, and such Merchants restricted share shall be canceled and converted into the right to receive an amount of cash equal to the value of the mixed election consideration plus dividends, if any, accrued but unpaid as of the effective time with respect to such restricted share.

Treatment of Merchants Warrants. Each organizers' warrant to purchase Merchants common stock outstanding as of the effective time will be converted at the effective time into a warrant to acquire, upon payment of the amount determined by dividing the per share exercise price immediately prior to the effective time by the stock election consideration of 0.9630, the number of shares of Community Bank System common stock determined by multiplying (i) the number of shares of Merchants common stock which may be acquired upon exercise of such organizers' warrant immediately prior to the effective time by (ii) the stock election consideration of 0.9630. As of January 15, 2017, Don Chase held organizers' warrants for 1,208 shares with an exercise price of \$41.39 per share.

Equity Awards of Certain Directors and Executive Officers

For certain executive officers, Merchants accelerated the vesting of outstanding equity awards that would otherwise have vested at the effective time of the Merger, so that such awards vested in December 2016 in order to mitigate the impact of Section 4999 of the Code, as discussed in more detail below. In connection with such acceleration, each executive officer agreed to (i) hold such accelerated shares through the earlier of his or her termination of employment with Merchants or the closing of the Merger and (ii) repay to Merchants an amount, in cash, equal to the compensation recognized by such executive officer, less applicable employment and income taxes, for the accelerated shares should he or she terminate employment prior to closing of the Merger.

Outstanding stock options held by Mr. Tuttle were scheduled to expire on December 31, 2016 if they had not been exercised as of such date. Due to the pendency of the Merger, Merchants extended the exercise period with respect to Mr. Tuttle's stock options until the earlier of (i) the closing of the Merger, and (ii) the original expiration date of the options. As of January 15, 2017, Mr. Tuttle held options to purchase 26,520 shares of Merchants stock with a weighted average exercise price of \$22.50.

Retention Incentives for Executive Officers

In order to incentivize and motivate certain executives who are not expected to be retained on a long-term basis following the closing of the Merger to provide critical services during the pendency of the Merger, Community Bank System has entered into retention agreements with each of Messrs. Cataldo and Watson and Ms. Thresher, Abbott, and Dragon. Under these retention agreements, an amount equal to 40% of the executive's 2016 base salary (or 50% of base salary, in the case of Ms. Thresher) will become payable upon the closing of the Merger, subject to the executive's continued service through the closing of the Merger and completion of certain activities and other items prior to the closing of the Merger related to the integration of Merchants with Community Bank System. In the event that the retention bonus (together with any other payments to the executive officers) would constitute a parachute payment and would be subject to the excise tax imposed by Section 4999 of Code, such amounts would be reduced to the largest payment possible without the imposition of an excise tax under Section 4999 of the Code.

In addition, for performance in 2016, Merchants granted restricted stock awards under the 2008 Stock Incentive Plan in early 2017 to these executive officers (the 2017 Restricted Stock Awards). The value of each restricted stock award was approximately 15% of each executive officer's respective 2017 base salary and has terms and conditions consistent with Merchants' past practice, which include three-year cliff vesting subject to acceleration upon a change in control of

Merchants, including as a result of the Merger.

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The following table quantifies the payments and benefits that Merchants' executive officers may receive in connection with the Merger due to the accelerated vesting of unvested restricted shares held as of January 15, 2017 and the payment of retention incentives. As of January 15, 2017, none of Merchants' executive officers held any stock options and none of Merchants' directors held unvested restricted shares or unvested stock options or had received, or were expected to receive, any retention incentives.

Executive Officer	Restricted Stock		Value of 2017 Restricted Stock Award (\$) ⁽³⁾	Value of Retention Bonus (\$)	Total (\$)
	Number of Shares	Estimated Value (\$) ⁽¹⁾⁽²⁾			
Laura Abbott	879	37,621	24,000	62,000	123,621
Bruce Bernier	1,204	51,531			51,531
Anita Bourgeois					
Michael Cataldo	342	14,638	22,800	59,200	96,638
Richard Donovan					
Jacqueline Dragon	1,463	62,616	22,650	58,000	143,266
Geoffrey Hesslink	6,153	263,348			263,348
Marie Thresher	3,182	136,190	45,750	145,000	326,940
Jonathan Watson	879	37,621	25,650	65,200	128,471

Amounts based upon multiplying the number of shares of restricted stock held by the executive officer by \$42.80

(1) (the average closing price of a share of Merchants stock over the first five business days following the public announcement of the Merger).

As discussed above in "Equity Awards of Certain Directors and Executive Officers", Merchants accelerated the restricted stock held by certain executive officers as of December 27, 2016 in order to mitigate the impact of Section 4999 of the Code. Accordingly, the value of the stock recognized upon such acceleration by each such executive is as follows: Ms. Abbott \$47,862; Mr. Cataldo \$18,622; Ms. Dragon \$79,660; Ms.

(2) Thresher \$173,260; and Mr. Watson \$47,862. The value is based upon the closing price of a share of Merchants stock of \$54.45 as of December 27, 2016. In accordance with the terms of the applicable restricted stock agreements, Merchants withheld a number of shares upon vesting in order to satisfy the minimum tax withholding due. Accordingly, the actual number of shares to be exchanged in the merger by each executive is less than the number of shares set forth in the table above and the amount ultimately recognized in the merger by each executive may be more or less than the amount recognized upon the acceleration.

Amounts reflect the actual value of the 2017 Restricted Stock Award granted on January 18, 2017 (calculated as a percentage of each executive officer's current base salary). The number of shares subject to the 2017 Restricted Stock Awards granted to each executive is as follows: Ms. Abbott 474 shares; Mr. Cataldo 451 shares; Ms.

(3) Dragon 448 shares; Ms. Thresher 904 shares; and Mr. Watson 507 shares. The actual value the executive officers may receive in the Merger with respect to such 2017 Restricted Stock Award may be more or less than this amount depending upon the difference between the value of Merchants stock as of January 18, 2017 and the actual per share merger consideration.

Severance Arrangements with Merchants

Merchants has an existing employment agreement with each of its executive officers (other than Richard Donovan and Eric Segal), which provides that if, within 24 months following a change in control, an executive is terminated without cause or resigns for good reason, the executive will be paid a lump sum amount equal to the sum of (i) a prorated bonus and (ii) three times (for Mr. Hesslink) or two times (for the other executives) the executive's then-current base salary. Furthermore, Merchants will continue to pay its share of the cost of health insurance for the executive for up to 18 months following such termination. The prorated bonus portion of the cash severance shall be calculated as the amount payable under Merchants' annual incentive compensation plan based on the extent to which the applicable performance criteria for the year of termination of employment have been achieved, as measured through the end of the most recently

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completed calendar quarter, multiplied by a fraction, the numerator of which shall be the number of days the executive was employed by Merchants in the year of termination of employment and the denominator of which shall be 365.

In the event that any payments to the executive officers would constitute a parachute payment and would be subject to the excise tax imposed by Section 4999 of the Code, such amounts would be reduced to the largest payment possible without the imposition of an excise tax under Section 4999 of the Code. As noted above, Merchants has accelerated the vesting of certain equity awards that would otherwise have vested at the effective time of the Merger, so that such awards vested in December 2016 in order to mitigate the impact of Section 4999 of the Code.

In December 2016, Merchants entered into an employment agreement with Richard Donovan as interim Principal Accounting Officer, interim Principal Financial Officer, and interim Treasurer. The employment agreement provides that Mr. Donovan's employment will automatically terminate upon the closing of the Merger. If Mr. Donovan's employment is terminated without cause prior to the closing of the Merger, he shall receive the base salary he otherwise would have received had he remained employed until the earliest of (1) the end of the 90 day period following his termination date, (2) the closing of the Merger, or (3) the date that Merchants determines to be the end of the merger process. Mr. Donovan could receive severance in the form of base salary continuation for up to 90 days, or approximately \$56,250.

As described below, Community Bank System has entered into employment agreements with each of Messrs. Hesslink and Bernier, and Ms. Bourgeois, which agreements will become effective upon the closing of the Merger and will supersede the employment agreements each executive is currently party to with Merchants.

Community Bank System has confirmed its intention to honor the terms of the employment agreements with Messrs. Cataldo and Watson and Meses. Thresher, Abbott, and Dragon. Community Bank System further acknowledged that these executive officers would have good reason to resign following the closing of the Merger. The following table quantifies the potential payments and benefits that these executive officers may receive under their employment agreements, assuming a termination without cause or resignation for good reason following the Merger. As noted above, such amounts may be subject to reduction to the extent necessary to avoid the imposition of an excise tax under Section 4999 of the Code.

Executive Officer	Severance Payment (\$) ⁽¹⁾	Estimated Value of Benefits Continuation (\$)	Total (\$)
Laura Abbott	321,644	23,101	344,745
Michael Cataldo	305,562	22,930	328,491
Jacqueline Dragon	303,551	8,221	311,773
Marie Thresher	613,760		613,760
Jonathan Watson	343,757	22,763	366,519

For purposes of this table, the prorated bonus portion of the severance was calculated based upon target bonus opportunity, and assuming a termination of employment on January 15, 2017. Because the actual termination date is expected to occur on or following the effective time of the Merger, which is expected to occur in late second quarter or early third quarter of 2017, the actual prorated bonus may be more than this amount.

New Employment Agreements with Community Bank System

Community Bank System entered into employment agreements with each of Messrs. Hesslink and Bernier, and Ms. Bourgeois, which agreements will become effective upon the closing of the Merger and will supersede the employment agreements each executive is currently party to with Merchants. Mr. Hesslink has accepted a position with Community Bank System as Regional President, New England, Mr. Bernier has accepted a position with Community Bank System as Senior Lender for Vermont, and Ms. Bourgeois has accepted a position with Community Bank System as the Vice President of Retail and Municipal Banking for New England, in each case, effective upon and following the closing of the Merger.

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Under the new agreements, each executive will receive a signing bonus payable upon the first payroll date following the effective date of the Merger in the following amount: Mr. Hesslink, \$1,281,000; Mr. Bernier, \$500,000; and Ms. Bourgeois, \$360,000. Mr. Hesslink's base salary will be \$350,000 with target incentive compensation of 25% of base salary; Mr. Bernier's base salary will be \$160,000 with target incentive compensation of 25% of base salary; and Ms. Bourgeois' base salary will be \$160,000 with target incentive compensation of 20% of base salary. If the executive is terminated without cause or resigns for good reason during the term of the employment agreement (which is two years for Mr. Bernier and Ms. Bourgeois, and three years for Mr. Hesslink) or within 12 months after the term of the agreement expires (or 24 months for Mr. Hesslink), the executive will be entitled to accelerated vesting of equity awards and severance in an amount equal to the sum of the executive's base salary and most recent bonus amount (or target bonus if no payment has yet been made or if such bonus was for a partial year). Upon a termination for any reason other than for cause within two years after a change in control, Mr. Hesslink shall receive the greater of (i) two times the sum of his base salary and any payments made under the management incentive plan in the previous 12 months, or (ii) base salary plus expected payments to be made under the management incentive plan. The agreements contain restrictive covenants, including non-solicitation and non-competition covenants.

In the event that any payments to the executive officers under the employment agreements (together with any other payments) would constitute a parachute payment and would be subject to the excise tax imposed by Section 4999 of the Code, such amounts would be reduced to the largest payment possible without the imposition of an excise tax under Section 4999 of the Code unless payment of the full amount despite payment of the excise tax would be a greater net amount.

Regulatory Requirements

Notwithstanding the foregoing, all payments and benefits under the Merchants plans and arrangements are subject to any required regulatory approval or satisfaction of a condition in any regulatory approval, as applicable.

Director Deferred Compensation

Certain of Merchants' directors have deferred compensation under Merchants' director deferred compensation plans. All such deferred compensation is fully vested. Community Bank System will honor the terms and obligations of Merchants' director deferred compensation plans, unless such plans are terminated prior to the effective time of the Merger by mutual agreement of Merchants and Community Bank System.

Retained Directors

At the effective time of the Merger, Community Bank System will expand the size of its board of directors by two seats and appoint two directors of Merchants to the board of directors of Community Bank System and Community Bank. Each appointed director will qualify as an Independent Outside Director of Community Bank System under ISS Guidelines and will meet all legal and regulatory requirements for serving on the board of directors of Community Bank System. One appointed director will be appointed to the class of directors of Community Bank System with terms expiring at the second annual meeting of stockholders occurring after the effective time of the Merger and the other appointed director will be appointed to the class of directors of Community Bank System with terms expiring at the third annual meeting of stockholders occurring after the effective time of the Merger. It is currently expected that Jeffrey L. Davis and Raymond C. Pecor III will be the members of the Merchants board of directors who will be appointed to the board of directors Community Bank System.

Indemnification

Pursuant to the Merger Agreement, Community Bank System has agreed that it will, from and after the effective time of the Merger, indemnify and hold harmless the present and former directors, officers and employees of Merchants and its subsidiaries against any costs or expenses, judgments, settlements effected with the prior written consent of Community Bank System, fines, losses, taxes, damages or liabilities incurred in connection with any claim, action, suit, proceeding or investigation arising before or after the effective time of the Merger, arising in whole or in part out of, or pertaining to the fact that such person is or was a director, officer or employee of Merchants or its subsidiaries, or otherwise in connection with any action taken or not

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taken at the request of Merchants or its subsidiaries or is or was serving at the request of Merchants or its subsidiaries as a director, officer employee, agent, trustee or fiduciary of another person and pertaining to matters, acts or omissions existing or occurring at or prior to the effective time of the Merger, including matters, acts or omissions occurring in connection with the approval of the Merger Agreement and the transactions contemplated thereby, to the fullest extent permitted by applicable law. Community Bank System has also agreed to advance expenses as incurred by any indemnified party to the fullest extent permitted by applicable law within thirty days after a written request setting forth such expenses in reasonable detail, provided that such indemnified party to whom expenses are advanced provides an undertaking to repay such advances if it is ultimately decided that such indemnified party is not entitled to indemnification.

Directors and Officers Insurance

Community Bank System has further agreed that for a period of six years after the effective time of the Merger, it will cause to be maintained in effect the current policies of directors and officers liability insurance maintained by Merchants with respect to claims against them arising from matters, acts or omissions occurring at or before the effective time of the Merger (including the transactions contemplated by the Merger Agreement). Community Bank System will not be obligated to expend, on an annual basis, an amount in excess of three hundred percent of the current annual premium paid as of the date of the Merger Agreement by Merchants for such directors and officers liability insurance (the premium cap) and if such premiums at any time exceed the premium cap, then Community Bank System shall cause to be maintained policies of insurance which will provide the maximum coverage available at an annual premium equal to the premium cap. In lieu of the foregoing, Merchants in consultation with Community Bank System may obtain at or prior to the effective time a substitute policy for a price that in the aggregate does not exceed the premium cap.

Merger-Related Executive Compensation for Merchants Named Executive Officers

The table below sets forth the information required by Item 402(t) of Regulation S-K regarding the compensation that is based on or otherwise relates to the Merger for Merchants named executive officers who are receiving compensation relating to the Merger, assuming that (i) a change of control of Merchants occurred on January 15, 2017, the latest practicable date prior to the filing of this proxy/prospectus, (ii) the price per share of Merchants common stock is \$42.80 (the average closing market price of Merchants common stock on NASDAQ over the first five business days following the October 24, 2016 public announcement of the Merger Agreement), (iii) the named executive officer's base salary rates and annual target bonuses remain unchanged from those in place as of such date, and (iv) no named executive officer receives any additional equity grants on or prior to the effective time of the Merger other than the 2017 Restricted Stock Grant to Ms. Thresher as described above under Retention Incentives for Executive Officers. Amounts set forth in the table may be subject to reduction to the extent necessary to avoid the imposition of an excise tax under Section 4999 of the Code.

As described above, Merchants has entered into employment agreements with Mr. Hesslink and Ms. Thresher. At the time of the execution of the merger agreement, Mr. Hesslink entered into a new employment agreement with Community Bank System that will supersede his existing employment agreement with Merchants effective upon the closing of the Merger. Ms. Thresher remains subject to her employment agreement with Merchants. For Mr. Hesslink, the table presents the terms of his new employment agreement with Community Bank System and assumes he will not be terminated and will be employed by Community Bank System following the closing of the merger. For Ms. Thresher, it is assumed that she is terminated without cause or resigns for good reason immediately following the closing of the Merger.

Golden Parachute Compensation

Name	Cash (\$) ⁽¹⁾	Equity (\$) ⁽²⁾	Other (\$) ⁽³⁾	Total (\$)
Geoffrey Hesslink (President and Chief Executive Officer)		263,348	1,281,000	1,544,348
Marie Thresher (Executive Vice President, Chief Operating Officer)	613,760	181,940	145,000	940,700

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- Amount equals the total cash severance upon a qualifying termination of employment. The cash severance payment is double-trigger (*i.e.*, it is contingent upon a qualifying termination of employment following the effective time of the Merger). The severance amount will be paid in a lump sum. For purposes of this table, the prorated bonus
- (1) portion of the severance was calculated based upon target bonus opportunity, and assuming a termination of employment on January 15, 2017. Because the actual termination date is expected to occur on or following the effective time of the Merger, which is expected to occur in late second quarter or early third quarter of 2017, the actual prorated bonus may be less than this amount.
- Amount equals the value of the single-trigger vesting for the unvested equity held by the executive upon the consummation of the Merger. The value is based upon a price per share of \$42.80, which is the average closing
- (2) price of Merchants stock on NASDAQ over the first five business days following the public announcement of the Merger Agreement. For Ms. Thresher, the amount includes the value of the 2017 Restricted Stock Award awarded in 2017. For a discussion of the treatment of unvested equity and the assumptions with respect to such 2017 Restricted Stock Award, see Retention Incentives for Executive Officers above.
- Amount equals the signing bonus that Mr. Hesslink will receive from Community Bank System and the cash
- (3) retention bonus that Ms. Thresher will receive from Community Bank System upon the closing of the Merger. Each such payment will be paid in a lump sum.

Material U.S. Federal Income Tax Consequences of the Merger

The following discussion, subject to the limitations and qualifications described herein, insofar as it presents legal conclusions with respect to matters of U.S. federal income tax law, constitutes the opinion of Goodwin Procter as to the material U.S. federal income tax consequences to U.S. holders of Merchants common stock that exchange their shares of Merchants common stock in the Merger, and is based on, and subject to, the Code, the Treasury regulations promulgated under the Code, existing interpretations, court decisions, and administrative rulings, all of which are in effect as of the date of this proxy statement/prospectus, and all of which are subject to change, possibly with retroactive effect. Any such change could affect the continuing validity of the discussion.

This summary only addresses the material U.S. federal income tax consequences of the Merger to the Merchants stockholders that hold Merchants common stock as a capital asset within the meaning of Section 1221 of the Code.

This summary does not address all aspects of U.S. federal income taxation that may be applicable to Merchants stockholders in light of their particular circumstances or to Merchants stockholders subject to special treatment under U.S. federal income tax law, such as:

- stockholders who are not U.S. holders;
- pass-through entities or investors in pass-through entities;
 - financial institutions;
 - insurance companies;
 - tax-exempt organizations;
- brokers, banks or dealers in securities or currencies;
- traders in securities that elect to use a mark-to-market method of accounting;
- persons whose functional currency is not the U.S. dollar;
- persons who purchased or sell their shares of Merchants common stock as part of a wash sale;
- stockholders who hold their shares of Merchants common stock as part of a hedge, straddle, constructive sale or conversion transaction; and
- stockholders who acquired their shares of Merchants common stock pursuant to the exercise of employee stock options or otherwise acquired shares as compensation or through a tax-qualified retirement plan.

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In addition, the discussion does not address any alternative minimum tax or any state, local or foreign tax consequences of the Merger, nor does it address any tax consequences arising under the unearned income Medicare contribution tax pursuant to the Health Care and Education Reconciliation Act of 2010.

U.S. Holders

For purposes of this summary, the term "U.S. holder" means a beneficial holder of Merchants common stock that is:

a citizen or resident of the U.S.; or
a corporation (including any entity treated as a corporation for U.S. federal income tax purposes) created or organized under the laws of the U.S. or any of its political subdivisions; or
an estate that is subject to U.S. federal income tax on its income regardless of its source.

If a partnership (including any entity or arrangement, domestic or foreign, that is treated as a partnership for U.S. federal income tax purposes) holds Merchants common stock, the tax treatment of a partner will generally depend on the status of the partners and the activities of the partnership. Partnerships and partners in such a partnership should consult their tax advisers about the tax consequences of the Merger to them.

The Merger

It is a condition to Merchants' obligation to complete the Merger that Merchants receive an opinion from Goodwin Procter, dated as of the closing date of the Merger, to the effect that the Merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Code. It is a condition to Community Bank System's obligation to complete the Merger that Community Bank System receive an opinion from Cadwalader, dated as of the closing date of the Merger, to the effect that the Merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Code. In addition, in connection with the filing of the registration statement of which this document is a part, Goodwin Procter has delivered an opinion to Merchants to the same effect as the opinion described above. These opinions will be based on representation letters provided by Merchants and Community Bank System and on customary factual assumptions. None of the opinions described above will be binding on the Internal Revenue Service. Merchants and Community Bank System have not sought and will not seek any ruling from the Internal Revenue Service regarding any matters relating to the Merger, and as a result, there can be no assurance that the Internal Revenue Service will not assert, or that a court would not sustain, a position contrary to any of the conclusions set forth below. In addition, if any of the representations or assumptions upon which those opinions are based are inconsistent with the actual facts, the United States federal income tax consequences of the Merger could be adversely affected. Based on factual representations contained in the representation letters provided by Merchants and Community Bank System, and on certain customary factual assumptions, all of which representations and assumptions must continue to be true and accurate as of the effective time of the Merger, in the opinion of Goodwin Procter, the Merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Code.

The tax consequences of the Merger to a U.S. holder of Merchants common stock will generally depend upon the form of consideration such U.S. holder receives in the Merger.

Exchange for Solely Community Bank System Common Stock. Pursuant to the Merger Agreement, upon exchanging all of your shares of Merchants common stock for solely Community Bank System common stock (and cash instead of fractional shares of Community Bank System common stock), you will generally not recognize gain or loss, except with respect to cash received instead of fractional shares of Community Bank System common stock (see "Cash Instead of Fractional Shares" below).

Exchange for Solely Cash. Pursuant to the Merger Agreement, upon exchanging all of your shares of Merchants common stock for solely cash, you will generally recognize gain or loss equal to the difference between the amount of cash you receive and your cost basis in your Merchants common stock.

Exchange for Community Bank System Common Stock and Cash. Pursuant to the Merger Agreement, upon exchanging all of your shares of Merchants common stock for a combination of Community Bank System common stock and cash, you will generally recognize gain (but not loss) in an amount equal to the lesser of: (1) the amount of cash treated as received in exchange for Merchants common stock in the Merger

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(excluding any cash received in lieu of fractional shares of Community Bank System common stock); and (2) the excess, if any, of (a) the sum of the amount of cash treated as received in exchange for Merchants common stock in the Merger (excluding any cash received in lieu of fractional shares of Community Bank System common stock) plus the fair market value of Community Bank System common stock (including the fair market value of any fractional share) received in the Merger, over (b) your cost basis in the Merchants common stock exchanged. If you acquired different blocks of Merchants common stock at different times or at different prices, you should consult your individual tax advisor regarding the manner in which gain or loss should be determined.

Except as described in the section entitled Dividend Treatment below, any recognized gain will generally be long-term capital gain if, as of the effective date of the Merger, your holding period with respect to the surrendered Merchants common stock exceeds one year. The aggregate tax basis of the Community Bank System common stock you receive as a result of the Merger (including any fractional shares of Community Bank System common stock deemed received) will be the same as your aggregate tax basis in Merchants common stock you surrender in the Merger, decreased by the amount of cash you receive that is treated as received in exchange for Merchants common stock (excluding any cash received in lieu of a fractional share of Community Bank System common stock) and increased by the amount of gain, if any, you recognize in the exchange (excluding any gain resulting from cash received in lieu of a fractional share of Community Bank System common stock). The holding period of the Community Bank System common stock you receive as a result of the exchange will include the holding period of Merchants common stock you surrendered in the Merger.

Cash Instead of Fractional Shares. If you receive cash in the Merger instead of a fractional share interest in Community Bank System common stock, you will be treated as having received such fractional share in the Merger, and then as having received cash in exchange for such fractional share. Gain or loss would be recognized in an amount equal to the difference between the amount of cash received and your adjusted tax basis allocable to such fractional share. Except as described in the section entitled Dividend Treatment below, this gain or loss will generally be a capital gain or loss, and will be long-term capital gain or loss if, as of the effective date of the Merger, you have held your shares of Merchants common stock for more than one year.

Dividend Treatment. There are certain circumstances in which all or part of the gain you recognize will be treated as a dividend rather than as capital gains. In general, this determination depends upon whether, and to what extent, the Merger reduces your deemed percentage share ownership interest in Community Bank System. Because the possibility of dividend treatment depends primarily upon your particular circumstances, including the application of certain constructive ownership rules, you should consult your own tax advisor regarding the potential tax consequences of the Merger to you.

Backup Withholding and Information Reporting

In general, information reporting requirements may apply to the cash payments made to a U.S. holder in connection with the Merger, unless an exemption applies. Backup withholding may be imposed on the above payments if a U.S. holder (1) fails to provide a taxpayer identification number or appropriate certificates or (2) otherwise fails to comply with all applicable requirements of the backup withholding rules.

Any amounts withheld from payments to a U.S. holder under the backup withholding rules are not an additional tax and will be allowed as a refund or credit against the U.S. holder's applicable U.S. federal income tax liability, provided the required information is furnished to the IRS. U.S. holders should consult their own tax advisors regarding the application of backup withholding based on their particular circumstances and the availability and procedure for obtaining an exemption from backup withholding.

The foregoing discussion is for general information purposes only and is not intended to be a complete analysis or description of all potential U.S. federal income tax consequences of the Merger. The discussion does not address tax consequences which may vary with, or are contingent on, your individual circumstances. Moreover, the discussion does not address any non-income tax or any foreign, state or local tax consequences of the Merger. Accordingly, you are strongly encouraged to consult with your own tax advisor as to the tax consequences of the Merger in your particular circumstances, including the applicability and effect of the unearned income Medicare contribution tax pursuant to the

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Health Care and Education Reconciliation Act of 2010, the alternative minimum tax and any state, local or foreign and other tax laws and of changes in those laws.

Accounting Treatment of the Merger

The Merger will be accounted for as a business combination, as that term is used under generally accepted accounting principles, for accounting and financial reporting purposes, with Community Bank System treated as the acquirer.

Under the acquisition method of accounting, the assets (including identifiable intangible assets) and liabilities (including executory contracts and other commitments) of Merchants as of the effective time of the Merger will be recorded at their respective fair values and added to those of Community Bank System. Any excess of purchase price over the fair values is recorded as goodwill. Consolidated financial statements of Community Bank System issued after the Merger would reflect these fair values and would not be restated retroactively to reflect the historical financial position or results of operations of Merchants.

Restrictions on Sales of Community Bank System Common Stock by Certain Affiliates

The shares of Community Bank System common stock to be issued in the Merger will be freely transferable under the Securities Act, except for shares issued to any stockholder who is an affiliate of Community Bank System as defined by Rule 144 under the Securities Act. Affiliates consist of individuals or entities that control, are controlled by, or are under common control with Community Bank System and include the executive officers and directors of Community Bank System and may include significant stockholders of Community Bank System.

New York Stock Exchange Listing

Community Bank System has agreed to make an application to list the shares of its common stock to be issued in the Merger on the NYSE. The stock must be authorized for listing on the NYSE, subject to official notice of issuance, for the Merger to be completed.

Regulatory Approvals and Notices for the Merger

Pursuant the Merger Agreement, Community Bank System will submit applications for all necessary regulatory approvals and will give all requisite notices to governmental agencies regarding both the Merger and the Bank Merger. Certain approvals must be obtained from, or other filings made with, various bank regulatory and other authorities, including the OCC, the Federal Reserve Board, and state banking regulators.

The closing of the Merger is conditioned upon the receipt of all approvals of regulatory authorities required for the Merger and the Bank Merger, the expiration of all notice periods and waiting periods after the grant of regulatory approvals, and the satisfaction of all conditions contained in any regulatory approvals or consents.

The Comptroller of the Currency. The Bank Merger is subject to approval by the OCC. Community Bank filed an application on December 7, 2016. Following the OCC approval, the Bank Merger Act imposes a waiting period of up to 30 days after the OCC approval in order to permit the United States Department of Justice to file any objections to the Bank Merger under the federal antitrust laws. This waiting period may be reduced to 15 days if the Department of Justice has not provided any adverse comments relating to the competitive factors of the transaction, which the parties

expect to occur.

Federal Reserve Board. The Federal Reserve Board is Community Bank System's primary federal banking regulator. The Merger is subject to approval by the Federal Reserve Board. Community Bank System filed an application with the Federal Reserve Board on December 7, 2016 requesting approval of the Merger. In determining whether to approve the proposed transaction, the Federal Reserve Board will consider factors such as financial and managerial resources, future prospects, the convenience and needs to the community and competitive factors.

You should be aware that any governmental agency approval issued:

reflects only the agency's views that the transaction does not contravene applicable competitive standards imposed by law and is consistent with regulatory requirements and policies; and

is not an endorsement of or recommendation for the transaction.

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Appraisal or Dissenters Rights

Holders of shares of Merchants common stock who meet certain requirements are entitled to seek appraisal rights.

Under Section 262 of the Delaware General Corporation Law, or the DGCL, holders of shares of Merchants common stock who do not vote in favor of the adoption of the Merger Agreement and who otherwise follow the procedures set forth in Section 262 of the DGCL (which we refer to as Section 262) will be entitled to have their shares appraised by the Delaware Court of Chancery and to receive payment in cash for the fair value of the shares, exclusive of any element of value arising from the accomplishment or expectation of the Merger, together with interest, determined as described below.

Failure to follow precisely any of the statutory requirements could result in the loss of your appraisal rights.

The following discussion is not a complete statement of the law pertaining to appraisal rights under the DGCL and is qualified in its entirety by the full text of Section 262, which is attached to this Proxy Statement/Prospectus as **Annex C**. The following summary does not constitute any legal or other advice nor does it constitute a recommendation that

Merchants stockholders exercise their appraisal rights under Section 262. Only a holder of record of shares of Merchants common stock is entitled to demand appraisal of the shares registered in that holder's name. A person having a beneficial interest in shares of common stock of Merchants held of record in the name of another person, such as a broker, fiduciary, depositary or other nominee, must act promptly to cause the record holder to follow the steps summarized below properly and in a timely manner to perfect appraisal rights. If you hold your shares of Merchants common stock through a broker, bank or other nominee and you wish to exercise appraisal rights, you should consult with your broker, bank or other nominee to determine the appropriate procedures for the making of a demand for appraisal by the nominee.

Under Section 262, where a merger agreement is to be submitted for adoption at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, must notify each of its stockholders as of the record date that appraisal rights are available, and must include in the notice a copy of Section 262. This Proxy Statement/Prospectus shall constitute such notice, and the full text of Section 262 is attached to this Proxy Statement/Prospectus as **Annex C**. In connection with the Merger, any holder of shares of Merchants common stock who wishes to exercise appraisal rights, or who wishes to preserve such holder's right to do so, should review the following discussion and **Annex C** carefully because failure to timely and properly comply with the procedures specified may result in the loss of appraisal rights. In addition, because of the complexity of the procedures for exercising the right to seek appraisal of shares of common stock, Merchants believes that if a stockholder is considering exercising such rights such stockholder should consider seeking legal and financial advice.

Filing Written Demand

Any holder of shares of Merchants common stock wishing to exercise appraisal rights must deliver to Merchants, before the vote on the adoption of the Merger Agreement at the Merchants special meeting, a written demand for the appraisal of the stockholder's shares, and that stockholder must not vote in favor of the adoption of the Merger Agreement. A holder of shares of Merchants common stock wishing to exercise appraisal rights must hold the shares of record on the date the written demand for appraisal is made and must continue to hold the shares of record through the effective time of the Merger. A proxy that is submitted and does not contain voting instructions will, unless revoked, be voted in favor of the adoption of the Merger Agreement, and will constitute a waiver of the stockholder's right of appraisal and nullify any previously delivered written demand for appraisal. Therefore, a stockholder who submits a proxy and who wishes to exercise appraisal rights must submit a proxy containing instructions to vote

against the adoption of the Merger Agreement or abstain from voting on the adoption of the Merger Agreement. Voting against the adoption of the Merger Agreement or abstaining from voting or failing to vote on the proposal to adopt the Merger Agreement will not by itself constitute a written demand for appraisal satisfying the requirements of Section 262. The written demand for appraisal must be in addition to and separate from any proxy or vote on the adoption of the Merger Agreement. The demand must reasonably inform Merchants of the identity of the holder, as well as the intention of the holder to demand an

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appraisal of the fair value of the shares held by the holder. A stockholder's failure to deliver the written demand prior to the taking of the vote on the adoption of the Merger Agreement at the Merchants special meeting will constitute a waiver of appraisal rights.

Only a holder of record of shares of Merchants common stock is entitled to demand appraisal rights for the shares registered in that holder's name. A demand for appraisal in respect of shares of Merchants common stock should be executed by or on behalf of the holder of record. If the shares are owned of record in a fiduciary capacity, such as by a trustee, guardian or custodian, execution of the demand should be made in that capacity, and if the shares are owned of record by more than one person, as in a joint tenancy and tenancy in common, the demand should be executed by or on behalf of all joint owners. An authorized agent, including an agent for two or more joint owners, may execute a demand for appraisal on behalf of a holder of record; however, the agent must identify the record owner or owners and expressly disclose that, in executing the demand, the agent is acting as agent for the record owner or owners.

Stockholders who hold their shares in bank, brokerage accounts or other nominee forms and who wish to exercise appraisal rights are urged to consult with their bank, broker or other nominee to determine the appropriate procedures for the making of a demand for appraisal by such nominee.

All written demands for appraisal pursuant to Section 262 should be delivered to the Corporate Secretary of Merchants at Merchants Bancshares, Inc., 275 Kennedy Drive, South Burlington, Vermont 05403.

Any holder of shares of Merchants common stock who has not commenced an appraisal proceeding or joined such proceeding as a named party may withdraw his, her or its demand for appraisal and accept the consideration offered pursuant to the Merger Agreement by delivering to the surviving corporation of the Merger a written withdrawal of the demand for appraisal and an acceptance of the Merger; however, any such attempt to withdraw the demand made more than 60 days after the effective date of the Merger will require written approval of the surviving corporation of the Merger. No appraisal proceeding in the Delaware Court of Chancery will be dismissed without the approval of the

Delaware Court of Chancery, and such approval may be conditioned upon such terms as the Delaware Court of Chancery deems just; provided, that this restriction will not affect the right of any former Merchants stockholder who has not commenced an appraisal proceeding or joined such proceeding as a named party to withdraw such stockholder's demand for appraisal and to accept the merger consideration within 60 days after the effective date of the Merger.

Notice by the Surviving Corporation

If the Merger is completed, within ten days after the effective time of the Merger, the surviving corporation of the Merger will notify each holder of shares of Merchants common stock who has made a written demand for appraisal pursuant to Section 262, and who has not voted in favor of or consented to the adoption of the Merger Agreement, that the Merger has become effective and the effective date thereof.

Filing a Petition for Appraisal

Within 120 days after the effective time of the Merger, but not thereafter, the surviving corporation of the Merger or any holder of shares of Merchants common stock who has so complied with Section 262 and is entitled to appraisal rights under Section 262 may file a petition in the Delaware Court of Chancery demanding a determination of the fair value of the shares held by all holders who have properly demanded appraisal of their shares. The surviving corporation of the Merger is under no obligation to file a petition or initiate any negotiations with respect to the fair value of shares of Merchants common stock. Community Bank System, which will be the surviving corporation of the Merger, has no present intention to, and holders of Merchants common stock should assume that Community Bank

System will not, file a petition or initiate any negotiations with respect to the fair value of shares of Merchants common stock. Accordingly, any holders of shares of Merchants common stock who desire to have their shares appraised should initiate all necessary action to perfect their appraisal rights in respect of shares of Merchants common stock within the time prescribed in Section 262.

Within 120 days after the effective time of the Merger, any holder of shares of Merchants common stock who has complied with the requirements for exercise of appraisal rights will be entitled, upon written request, to receive from the surviving corporation of the Merger a statement setting forth the aggregate number of shares of Merchants common stock not voted in favor of the adoption of the merger and with respect to which

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demands for appraisal have been received and the aggregate number of holders of such shares. The statement must be mailed to the stockholder within ten days after a written request therefor has been received by the surviving corporation of the Merger or within ten days after the expiration of the period for delivery of demands for appraisal, whichever is later. A beneficial owner of shares held either in a voting trust or by a nominee on behalf of such person may, in such person's own name, file a petition seeking appraisal or request the foregoing statement. As noted above, however, the demand for appraisal can only be made by a stockholder of record.

If a petition for an appraisal is timely filed by a holder of shares of Merchants common stock and a copy thereof is served upon the surviving corporation of the Merger, the surviving corporation will then be obligated within 20 days of service to file with the Delaware Register in Chancery a duly verified list containing the names and addresses of all stockholders who have demanded appraisal of their shares and with whom agreements as to the value of their shares have not been reached. After notice is provided to the stockholders as required by the court, the Delaware Court of Chancery is empowered to conduct a hearing on the petition to determine those stockholders who have complied with Section 262 and who have become entitled to appraisal rights thereunder. The Delaware Court of Chancery may require the stockholders who demanded appraisal of their shares to submit their stock certificates to the Register in Chancery for notation thereon of the pendency of the appraisal proceeding, and if any stockholder fails to comply with the direction, the Delaware Court of Chancery may dismiss the proceedings as to such stockholder.

Judicial Determination of Fair Value

After determining the holders of shares of Merchants common stock entitled to appraisal, the Delaware Court of Chancery will appraise the fair value of their shares, exclusive of any element of value arising from the accomplishment or expectation of the Merger, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining fair value, the Delaware Court of Chancery will take into account all relevant factors.

Stockholders considering seeking appraisal should be aware that the fair value of their shares as so determined could be more than, the same as or less than the consideration they would receive pursuant to the Merger Agreement if they did not seek appraisal of their shares. Although the parties to the Merger Agreement believe that the merger consideration is fair, no representation is made as to the outcome of the appraisal of fair value as determined by the Delaware Court of Chancery, and Merchants stockholders should recognize that such an appraisal could result in a determination of a value higher or lower than, or the same as, the value of the merger consideration. Stockholders should be aware that an investment banking opinion as to the fairness, from a financial point of view, of the consideration payable in a sale transaction, such as the Merger, is not an opinion as to, and does not otherwise address, fair value under Section 262. Neither Merchants nor Community Bank System anticipate offering more than the merger consideration to any Merchants stockholder exercising appraisal rights, and each of Merchants and Community Bank System reserves the right to assert, in any appraisal proceeding, that for purposes of Section 262, the fair value of a share of Merchants common stock is less than the value of the merger consideration, and that the methods that are generally considered acceptable in the financial community and otherwise admissible in court should be considered in the appraisal proceedings. If a petition for appraisal is not timely filed, then the right to an appraisal will cease. The costs of the action (which do not include attorneys' fees or the fees and expenses of experts) may be determined by the Delaware Court of Chancery and taxed upon the parties as the Delaware Court of Chancery deems equitable under the circumstances. The Delaware Court of Chancery may also order that all or a portion of the expenses incurred by a stockholder in connection with an appraisal, including, without limitation, reasonable attorneys' fees and the fees and expenses of experts utilized in the appraisal proceeding, be charged pro rata against the value of all the shares entitled to be appraised.

Unless the court in its discretion determines otherwise for good cause shown, interest from the effective date of the

Merger through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the Merger and the date of payment of the judgment.

If any stockholder who demands appraisal of shares of Merchants common stock under Section 262 fails to perfect, or successfully withdraws or loses, such holder's right to appraisal, the stockholder's shares of

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Merchants common stock will be deemed to have been converted at the effective time of the Merger into the right to receive the merger consideration applicable to such shares. A stockholder will fail to perfect, or lose or withdraw, the holder's right to appraisal if no petition for appraisal is filed within 120 days after the effective time of the Merger or if the stockholder delivers to the surviving corporation of the Merger a written withdrawal of the holder's demand for appraisal and an acceptance of the merger consideration in accordance with Section 262.

From and after the effective time of the Merger, no dissenting stockholder shall have any rights of a stockholder of Merchants with respect to that holder's shares for any purpose, except to receive payment of fair value and to receive payment of dividends or other distributions on the holder's shares of Merchants common stock, if any, payable to Merchants stockholders of record as of a time prior to the effective time of the Merger; provided, however, that if a dissenting stockholder delivers to the surviving corporation of the Merger a written withdrawal of the demand for an appraisal within 60 days after the effective time of the Merger and acceptance of the Merger, or subsequently with the written approval of the surviving corporation of the Merger, then the right of that dissenting stockholder to an appraisal will cease and the dissenting stockholder will be entitled to receive the merger consideration in accordance with the terms of the Merger Agreement. Once a petition for appraisal is filed with the Delaware Court of Chancery, however, the appraisal proceeding may not be dismissed as to any former Merchants stockholder without the approval of the court, and such approval may be conditioned upon such terms as the court deems just; provided, that such restriction shall not affect the right of any former Merchants stockholder who has not commenced an appraisal proceeding or joined the proceeding as a named party to withdraw such stockholder's demand for appraisal and to accept the merger consideration within 60 days after the effective time of the Merger.

Failure to comply strictly with all of the procedures set forth in Section 262 may result in the loss of a stockholder's statutory appraisal rights. Consequently, any Merchants stockholder wishing to exercise appraisal rights is urged to consult legal and financial advisors before attempting to exercise those rights.

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THE MERGER AGREEMENT

The following is a summary of the material provisions of the Merger Agreement. This summary is qualified in its entirety by reference to the Merger Agreement, a copy of which is included as Annex A to this Proxy Statement/Prospectus and is incorporated herein by reference. You should read the Merger Agreement carefully and in its entirety, as it is the legal document governing the Merger.

The Merger and the Bank Merger

The boards of directors of Community Bank System and Merchants have each unanimously approved and adopted the Merger Agreement, which provides for the merger of Merchants with and into Community Bank System, with Community Bank System as the surviving company in the Merger.

The Merger Agreement also provides that, unless otherwise determined by Community Bank System in its sole discretion, immediately after the effective time of the Merger, Merchants Bank, a Vermont-based commercial bank and wholly-owned subsidiary of Merchants, will merge with and into Community Bank, a national banking association and wholly-owned subsidiary of Community Bank System, with Community Bank as the surviving bank of such merger. The terms and conditions of the merger of Merchants Bank and Community Bank are set forth in a separate plan of merger and merger agreement, the form of which is attached as Exhibit A to the Merger Agreement, included as **Annex A** to this Proxy Statement/Prospectus. We refer to the merger of Merchants Bank and Community Bank as the Bank Merger.

Closing and Effective Time of the Merger

The closing of the Merger will take place at 10:00 a.m., New York City time, on a date which shall be no later than three business days after the satisfaction or waiver (subject to applicable law) of the latest to occur of the conditions to completion of the Merger (other than those conditions that by their nature can only be satisfied at the closing, but subject to the satisfaction or waiver thereof), unless another date, time or place is agreed to in writing by Community Bank System and Merchants. Simultaneously with the closing of the Merger, Community Bank System and Merchants will file a certificate of merger with the Secretary of State of the State of Delaware. The Merger will become effective at such time as the certificate of merger is filed or such other time as may be specified in the certificate of merger.

We currently expect that the Merger will be completed in late second quarter or early third quarter of 2017, subject to the adoption of the Merger Agreement by Merchants stockholders, regulatory approvals, and other conditions. However, completion of the Merger could be delayed if there is a delay in satisfying any other conditions to the Merger. No assurance is made as to whether, or when, Community Bank System and Merchants will complete the Merger. See Conditions to Completion of the Merger on page 78 of this Proxy Statement/Prospectus.

Board of Directors

At the effective time of the Merger, Community Bank System and Community Bank will each expand the size of its board of directors by two seats and appoint two directors of Merchants to serve on the boards of directors of Community Bank System and Community Bank. The two directors have not been determined yet, but will be mutually agreed upon by Community Bank System and Merchants. Each appointed director will qualify as an

Independent Outside Director under ISS Guidelines and will meet all legal and regulatory requirements for serving on the boards of directors of Community Bank System and Community Bank. With respect to the Community Bank System board of directors, one appointed director will be appointed to the class of directors with terms expiring at the second annual meeting of stockholders occurring after the effective time of the Merger and the other appointed director will be appointed to the class of directors with terms expiring at the third annual meeting of stockholders occurring after the effective time of the Merger.

Merger Consideration

Under the terms of the Merger Agreement, each share of Merchants common stock outstanding immediately prior to the effective time of the Merger (excluding certain shares held by Merchants, Community Bank System and their wholly-owned subsidiaries, which are referred to as excluded shares, and dissenting shares described below) will be converted into the right to receive, at the election of the holder thereof

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(subject to the proration procedures described below): (a) the mixed election consideration, which is a combination of \$12.00 in cash and 0.6741 shares of Community Bank System common stock; (b) the cash election consideration of \$40.00 in cash; or (c) the stock election consideration of 0.9630 shares of Community Bank System common stock.

No fractional shares of Community Bank System common stock will be issued in connection with the Merger.

Instead, each Merchants stockholder who would otherwise receive a fractional share of Community Bank System common stock will receive a cash payment, without interest, equal to: (i) the fractional share amount *multiplied by* (ii) the volume-weighted average trading price per share of Community Bank System common stock on the NYSE during the 20 trading day period ending on and including the third trading day immediately preceding the date of the closing of the Merger.

A Merchants stockholder also has the right to obtain the fair value of his or her shares of Merchants common stock in lieu of receiving the merger consideration by strictly following the appraisal procedures under Section 262 of the DGCL, attached as **Annex C**. Shares of Merchants common stock outstanding immediately prior to the effective time of the Merger and which are held by a stockholder who does not vote to adopt the Merger Agreement and who properly demands the fair value of such shares pursuant to, and who complies with, the appraisal procedures under the DGCL are referred to as dissenting shares. See Proposal I The Merger Appraisal or Dissenters Rights beginning on page 58 of this Proxy Statement/Prospectus.

If Community Bank System or Merchants changes the number of shares of Community Bank System common stock or Merchants common stock outstanding prior to the effective time of the Merger as a result of a reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock split or similar recapitalization with respect to the Community Bank System common stock or Merchants common stock and the record date for such corporate action is prior to the effective time of the Merger, then the merger consideration shall be appropriately and proportionately adjusted.

Based upon the closing sale price of the Community Bank System common stock on the NYSE of \$57.67 on February 2, 2017, the last practicable trading date prior to the printing of this Proxy Statement/Prospectus, the value of the mixed election consideration was approximately \$50.88.

The value of the shares of Community Bank System common stock to be issued to Merchants stockholders in the Merger will fluctuate between now and the closing date of the Merger. We make no assurances as to whether or when the Merger will be completed, and you are advised to obtain current sale prices for the Community Bank System common stock. See Risk Factors The value of the stock consideration will vary with changes in Community Bank System's stock price on page 15 of this Proxy Statement/Prospectus.

Election and Proration Procedures

Election Materials and Procedures

An election form will be mailed to each holder of record of Merchants common stock as of the close of business on the fifth business day prior to such mailing date (the election form record date), on a date to be mutually agreed by Community Bank System and Merchants that is not more than 45 days nor less than 30 days prior to the anticipated closing date of the Merger or on such other date as Community Bank System and Merchants mutually agree (the mailing date). Community Bank System will make available one or more election forms as may reasonably be requested from time to time by all persons who become holders or beneficial owners of Merchants common stock between the election form record date and the close of business on the business day prior to the 25th day following the

mailing date (the election deadline).

Each election form will permit the holder (or the beneficial owner through appropriate and customary documentation and instructions) to specify (i) the number of shares of such holder's Merchants common stock with respect to which such holder makes a mixed election, (ii) the number of shares of such holder's Merchants common stock with respect to which such holder makes a cash election and (iii) the number of shares of such holder's Merchants common stock with respect to which such holder makes a stock election. Any shares of Merchants common stock with respect to which the exchange agent has not received an effective, properly completed election form accompanied by related stock certificates or book-entry shares on

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or before the election deadline will be deemed to be no election shares, and the holders of such no election shares will be deemed to have made a mixed election with respect to such no election shares.

Any election form may be revoked or changed by the authorized person properly submitting such election form, by written notice received by the exchange agent prior to the election deadline. In the event an election form is revoked prior to the election deadline, the shares of Merchants common stock represented by such election form will become no election shares, except to the extent a subsequent election is properly made with respect to any or all of such shares of Merchants common stock prior to the election deadline. Subject to the terms of the Merger Agreement and the election form, the exchange agent will have reasonable discretion to determine whether any election, revocation or change has been properly or timely made and to disregard immaterial defects in the election forms, and any good faith decisions of the exchange agent regarding such matters shall be binding and conclusive. None of Community Bank System, Merchants or the exchange agent shall be under any obligation to notify any person of any defect in an election form.

Proration Procedures

A stockholder's ability to elect to receive cash or shares of Community Bank System stock in exchange for shares of Merchants common stock in the Merger is subject to proration procedures set forth in the Merger Agreement. These procedures are designed to ensure that the total amount of cash paid, and the total number of shares of Community Bank System common stock issued, in the Merger to the holders of shares of Merchants common stock, as a whole, will equal as nearly as practicable the total amount of cash and number of shares that would have been paid and issued if all shares of Merchants common stock were converted into the mixed election consideration.

Whether you receive the amount of cash and/or stock you request in your election form will depend in part on the elections of other Merchants stockholders. You may not receive the form of consideration that you elect in the Merger, and you may instead receive a pro-rata amount of cash and/or Community Bank System common stock.

The greater the oversubscription of the stock election, the less stock and more cash a Merchants stockholder making the stock election will receive. Reciprocally, the greater the oversubscription of the cash election, the less cash and more stock a Merchants stockholder making the cash election will receive. However, in no event will a Merchants stockholder who makes the cash election or the stock election receive less cash and more shares of Community Bank System common stock, or fewer shares of Community Bank System common stock and more cash, respectively, than a stockholder who makes the mixed election.

Set forth below are illustrative examples of how the proration and adjustment procedures will work in the event there is an oversubscription of the cash election or the stock election.

Example A Proration if Too Many Merchants Stockholders Elect to Receive All Cash. For purposes of this example, assume the following:

There are 6,883,644 outstanding shares of Merchants common stock.

Merchants stockholders make a mixed election with respect to 688,364 shares (or 10%) of Merchants common stock.

Merchants stockholders make a cash election with respect to 3,441,822 shares (or 50%) of Merchants common stock.

Merchants stockholders make a stock election with respect to the remaining 2,753,458 shares (or 40%) of Merchants common stock.

There are no shares of Merchants common stock outstanding subject to vesting or forfeiture restrictions, and no dissenting shares.

You hold 1,000 shares of Merchants common stock and have made an effective cash election with respect to those shares. In this example, proration would be required with respect to the Merchants stockholders who made a cash election.

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Step 1. Derive the cash election amount. The cash election amount equals the number of shares with respect to which cash elections have been made *multiplied* by the cash election consideration of \$40.00.

In this example, the cash election amount is calculated as follows:

$$3,441,822 * \$40.00 = \$137,672,880.00$$

Step 2. Derive the available cash election amount. The available cash election amount equals (a) the product of \$12.00 *multiplied* by the total number of shares of Merchants common stock issued and outstanding immediately prior to the effective time of the Merger, *minus* (b) the product of the total number of shares with respect to which a mixed election has been made *multiplied* by \$12.00, *minus* (c) the product of the total number of dissenting shares and shares of Merchants common stock subject to vesting or forfeiture restrictions as of immediately prior to the effective time of the Merger *multiplied* by the value of the mixed election consideration. The value of the mixed election consideration is equal to the sum of (i) \$12.00 and (ii) the product of (a) 0.6741 and (b) the volume-weighted average trading price of Community Bank System common stock on the NYSE during the 20 trading day period ending on and including the third trading day immediately preceding the effective date of the Merger.

In this example, the available cash election amount is calculated as follows:

$$(6,883,644 * \$12.00) - (688,364 * \$12.00) = \$74,343,360.00$$

Step 3. Determine the pro rata cash consideration to be received by each share of Merchants common stock with respect to which a cash election is made. The pro rata cash consideration is calculated by multiplying \$40.00 by a fraction, the numerator of which is the available cash election amount and the denominator of which is the cash election amount (such fraction, the cash fraction).

In this example, the pro rata cash consideration is calculated as follows:

$$\begin{aligned} & \$40.00 * \\ & \$74,343,360.00 \\ & \$137,672,880.00 \\ & = \$40.00 * 0.54 = \$21.60 \end{aligned}$$

Step 4. Determine the pro rata stock consideration to be received by each share of Merchants common stock with respect to which a cash election is made. The pro rata stock consideration is a number of shares of Community Bank System common stock equal to the stock election consideration of 0.9630 *multiplied* by one minus the cash fraction.

In this example, the pro rata stock consideration is calculated as follows:

$$0.9630 * (1 - 0.54) = 0.4430$$

Thus, in this example, if you own 1,000 shares of Merchants common stock and make a cash election with respect to those shares, you would receive:

\$21,600 in cash; and

443 shares of Community Bank System common stock.

Example B Proration if Too Many Merchants Stockholders Elect to Receive All Stock. For purposes of this example, assume the following:

There are 6,883,644 outstanding shares of Merchants common stock.

Merchants stockholders make the mixed election with respect to 688,364 shares (or 10%) of Merchants common stock.

Merchants stockholders make the cash election with respect to 688,364 shares (or 10%) of Merchants common stock.

Merchants stockholders make the stock election with respect to the remaining 5,506,915 shares (or 80%) of Merchants common stock.

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There are no shares of Merchants common stock outstanding subject to vesting or forfeiture restrictions, and no dissenting shares.

You hold 1,000 shares of Merchants common stock and have made an effective stock election with respect to those shares. In this example, proration would be required with respect to the Merchants stockholders who made a stock election.

Step 1. Derive the cash election amount. In this example, the cash election amount is calculated as follows:

$$688,364 * \$40.00 = \$27,534,560.00$$

Step 2. Derive the available cash election amount. In this example, the available cash election amount is calculated as follows:

$$(6,883,644 * \$12.00) - (688,364 * \$12.00) = \$74,343,360.00$$

Step 3. Determine the pro rata cash consideration to be received by each share of Merchants common stock with respect to which a stock election is made. The pro rata cash consideration is calculated by dividing the difference between the available cash election amount and the cash election amount by the number of Merchants shares with respect to which a stock election was made.

In this example, the pro rata cash consideration is calculated as follows:

$$\begin{aligned} & \$74,343,360.00 - \$27,534,560.00 \\ & \qquad \qquad \qquad 5,506,915 \\ & \qquad \qquad \qquad = \$8.50 \end{aligned}$$

Step 4. Determine the pro rata stock consideration to be received by each share of Merchants common stock with respect to which a stock election is made. The pro rata stock consideration is a number of shares of Community Bank System common stock equal to the stock election consideration of 0.9630 *multiplied by* a fraction, the numerator of which is the difference between the cash election consideration of \$40.00, and \$8.50 (the cash amount calculated in Step 3), and the denominator of which is the cash election consideration of \$40.00.

In this example, the pro rata stock consideration is calculated as follows:

$$\begin{aligned} & 0.9630 * \\ & (\$40.00 - \$8.50) \\ & \qquad \qquad \qquad \$40.00 \\ & \qquad \qquad \qquad = 0.7584 \end{aligned}$$

Thus, in this example, if you own 1,000 shares of Merchants common stock and make a stock election with respect to those shares, you would receive:

\$8,500 in cash; and
758 shares of Community Bank System common stock, plus cash in lieu of the additional 0.4 fractional share.

No Recommendation Regarding Elections

Neither Merchants nor Community Bank System is making any recommendation as to which merger consideration election a Merchants stockholder should make. If you are a Merchants stockholder, you must make your own decision with respect to these elections and may wish to seek the advice of your own attorneys or accountants.

Information About the Merger Consideration Elections

The mix of consideration payable to Merchants stockholders who make the cash election or the stock election will not be known until the results of the elections made by Merchants stockholders are tallied, which will not occur until near or after the closing of the Merger.

