

FIRST MIDWEST BANCORP INC  
Form 10-Q  
August 04, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 30, 2014

or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 0-10967

FIRST MIDWEST BANCORP, INC.  
(Exact name of registrant as specified in its charter)  
Delaware  
(State or other jurisdiction of incorporation or  
organization)  
One Pierce Place, Suite 1500  
Itasca, Illinois 60143-9768  
(Address of principal executive offices) (zip code)

36-3161078  
(IRS Employer Identification No.)

Registrant's telephone number, including area code: (630) 875-7450

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of July 31, 2014, there were 75,276,660 shares of common stock, \$.01 par value, outstanding.

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FIRST MIDWEST BANCORP, INC.

FORM 10-Q

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## PART I. FINANCIAL INFORMATION (Unaudited)

## ITEM 1. FINANCIAL STATEMENTS

FIRST MIDWEST BANCORP, INC.  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Amounts in thousands, except per share data)

|   | June 30,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| Assets  | (Unaudited)      |                      |
| Cash and due from banks   | \$155,099        | \$110,417            |
| Interest-bearing deposits in other banks                                | 322,874          | 476,824              |
| Trading securities, at fair value                                       | 18,231           | 17,317               |
| Securities available-for-sale, at fair value                            | 1,050,475        | 1,112,725            |
| Securities held-to-maturity, at amortized cost                          | 26,471           | 44,322               |
| Federal Home Loan Bank ("FHLB") and Federal Reserve Bank stock, at cost | 35,588           | 35,161               |
| Loans, excluding covered loans  | 5,843,457        | 5,580,005            |
| Covered loans   | 104,867          | 134,355              |
| Allowance for loan and covered loan losses                              | (78,326)         | (85,505)             |
| Net loans   | 5,869,998        | 5,628,855            |
| Other real estate owned ("OREO"), excluding covered OREO                | 30,331           | 32,473               |
| Covered OREO  | 9,825            | 8,863                |
| Federal Deposit Insurance Corporation ("FDIC") indemnification asset    | 10,276           | 16,585               |
| Premises, furniture, and equipment                                      | 118,305          | 120,204              |
| Investment in bank-owned life insurance ("BOLI")                        | 194,502          | 193,167              |
| Goodwill and other intangible assets                                    | 274,962          | 276,366              |
| Accrued interest receivable and other assets                            | 188,310          | 180,128              |
| Total assets  | \$8,305,247      | \$8,253,407          |
| Liabilities   |                  |                      |
| Noninterest-bearing deposits  | \$2,025,666      | \$1,911,602          |
| Interest-bearing deposits   | 4,869,584        | 4,854,499            |
| Total deposits  | 6,895,250        | 6,766,101            |
| Borrowed funds  | 104,201          | 224,342              |
| Senior and subordinated debt  | 190,996          | 190,932              |
| Accrued interest payable and other liabilities                          | 75,362           | 70,590               |
| Total liabilities   | 7,265,809        | 7,251,965            |
| Stockholders' Equity  |                  |                      |
| Common stock  | 858              | 858                  |
| Additional paid-in capital  | 407,895          | 414,293              |
| Retained earnings   | 878,607          | 853,740              |
| Accumulated other comprehensive loss, net of tax                        | (15,271)         | (26,792)             |
| Treasury stock, at cost   | (232,651)        | (240,657)            |
| Total stockholders' equity  | 1,039,438        | 1,001,442            |
| Total liabilities and stockholders' equity                              | \$8,305,247      | \$8,253,407          |

|           | June 30, 2014       |                  | December 31, 2013   |                  |
|-----------|---------------------|------------------|---------------------|------------------|
|           | Preferred<br>Shares | Common<br>Shares | Preferred<br>Shares | Common<br>Shares |
| Par Value | \$—                 | \$0.01           | \$—                 | \$0.01           |

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|                    |       |         |       |         |
|--------------------|-------|---------|-------|---------|
| Shares authorized  | 1,000 | 150,000 | 1,000 | 100,000 |
| Shares issued      | —     | 85,787  | —     | 85,787  |
| Shares outstanding | —     | 75,273  | —     | 75,071  |
| Treasury shares    | —     | 10,514  | —     | 10,716  |

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Amounts in thousands, except per share data)  
(Unaudited)

|  | Quarters Ended |          | Six Months Ended |           |
|--|----------------|----------|------------------|-----------|
|  | June 30,       |          | June 30,         |           |
|  | 2014           | 2013     | 2014             | 2013      |
| Interest Income  |                |          |                  |           |
| Loans, excluding covered loans   | \$60,634       | \$59,111 | \$119,636        | \$118,542 |
| Covered loans  | 2,605          | 4,151    | 4,543            | 7,600     |
| Investment securities  | 8,019          | 7,657    | 16,024           | 15,013    |
| Other short-term investments   | 745            | 834      | 1,490            | 1,643     |
| Total interest income  | 72,003         | 71,753   | 141,693          | 142,798   |
| Interest Expense   |                |          |                  |           |
| Deposits   | 2,511          | 3,003    | 5,108            | 6,323     |
| Borrowed funds   | 169            | 385      | 552              | 827       |
| Senior and subordinated debt   | 3,016          | 3,435    | 6,031            | 6,870     |
| Total interest expense   | 5,696          | 6,823    | 11,691           | 14,020    |
| Net interest income  | 66,307         | 64,930   | 130,002          | 128,778   |
| Provision for loan and covered loan losses   | 5,341          | 5,813    | 6,782            | 11,487    |
| Net interest income after provision for loan and covered loan losses                 | 60,966         | 59,117   | 123,220          | 117,291   |
| Noninterest Income   |                |          |                  |           |
| Service charges on deposit accounts  | 8,973          | 9,118    | 16,993           | 17,795    |
| Wealth management fees   | 6,552          | 6,126    | 13,009           | 11,965    |
| Card-based fees  | 5,969          | 5,547    | 11,304           | 10,623    |
| Mortgage banking income  | 959            | 1,010    | 2,074            | 2,978     |
| Other service charges, commissions, and fees   | 4,555          | 4,207    | 8,677            | 8,405     |
| Net securities gains   | 4,517          | 216      | 5,590            | 216       |
| Loss on extinguishment of debt   | (2,059)        | —        | (2,059)          | —         |
| Other income   | 1,727          | 1,217    | 2,855            | 3,034     |
| Total noninterest income   | 31,193         | 27,441   | 58,443           | 55,016    |
| Noninterest Expense  |                |          |                  |           |
| Salaries and employee benefits   | 34,561         | 32,921   | 68,052           | 69,490    |
| Net occupancy and equipment expense  | 7,672          | 7,793    | 17,063           | 15,940    |
| Professional services  | 6,517          | 5,595    | 11,906           | 10,813    |
| Technology and related costs   | 3,104          | 2,884    | 6,178            | 5,367     |
| Net OREO expense   | 1,569          | 1,084    | 3,125            | 2,883     |
| Other expenses   | 11,594         | 12,150   | 22,361           | 22,748    |
| Total noninterest expense  | 65,017         | 62,427   | 128,685          | 127,241   |
| Income before income tax expense   | 27,142         | 24,131   | 52,978           | 45,066    |
| Income tax expense   | 8,642          | 7,955    | 16,814           | 14,248    |
| Net income   | \$18,500       | \$16,176 | \$36,164         | \$30,818  |
| Per Common Share Data  |                |          |                  |           |
| Basic earnings per common share  | \$0.25         | \$0.22   | \$0.48           | \$0.41    |
| Diluted earnings per common share  | \$0.25         | \$0.22   | \$0.48           | \$0.41    |
| Dividends declared per common share  | \$0.08         | \$0.04   | \$0.15           | \$0.05    |
| Weighted-average common shares outstanding   | 74,322         | 74,017   | 74,235           | 73,942    |
| Weighted-average diluted common shares outstanding                                   | 74,333         | 74,024   | 74,247           | 73,950    |
| See accompanying notes to the unaudited condensed consolidated financial statements. |                |          |                  |           |



FIRST MIDWEST BANCORP, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

|   | Quarters Ended |          | Six Months Ended |          |
|---|----------------|----------|------------------|----------|
|   | June 30,       |          | June 30,         |          |
|   | 2014           | 2013     | 2014             | 2013     |
| Net income  | \$18,500       | \$16,176 | \$36,164         | \$30,818 |
| Securities available-for-sale                         |                |          |                  |          |
| Unrealized holding gains (losses):                    |                |          |                  |          |
| Before tax  | 12,031         | 1,164    | 24,721           | (852 )   |
| Tax effect  | (4,743 )       | (945 )   | (9,779 )         | (158 )   |
| Net of tax  | 7,288          | 219      | 14,942           | (1,010 ) |
| Reclassification of net gains included in net income: |                |          |                  |          |
| Before tax  | 4,517          | 216      | 5,590            | 216      |
| Tax effect  | (1,847 )       | (88 )    | (2,286 )         | (88 )    |
| Net of tax  | 2,670          | 128      | 3,304            | 128      |
| Net unrealized holding gains (losses)                 | 4,618          | 91       | 11,638           | (1,138 ) |
| Derivative instruments                                |                |          |                  |          |
| Unrealized holding losses:                            |                |          |                  |          |
| Before tax  | (198 )         | —        | (198 )           | —        |
| Tax effect  | 81             | —        | 81               | —        |
| Net of tax  | (117 )         | —        | (117 )           | —        |
| Unrecognized net pension costs                        |                |          |                  |          |
| Unrealized holding gains:                             |                |          |                  |          |
| Before tax  | —              | 10,997   | —                | 10,997   |
| Tax effect  | —              | (4,498 ) | —                | (4,498 ) |
| Net of tax  | —              | 6,499    | —                | 6,499    |
| Total other comprehensive income                      | 4,501          | 6,590    | 11,521           | 5,361    |
| Total comprehensive income                            | \$23,001       | \$22,766 | \$47,685         | \$36,179 |

|                                   | Accumulated<br>Unrealized<br>Gain (Loss)<br>on Securities<br>Available-<br>for-Sale | Accumulated<br>Unrealized<br>Loss on<br>Derivative<br>Instruments | Unrecognized<br>Net Pension<br>Costs | Total<br>Accumulated<br>Other<br>Comprehensive<br>Loss |
|-----------------------------------|---|---|--------------------------------------|--|
| Balance at December 31, 2012      | \$1,115   | \$—   | \$(16,775 )                          | \$(15,660 )  |
| Other comprehensive (loss) income | (1,138 )  | —   | 6,499                                | 5,361  |
| Balance at June 30, 2013          | \$(23 )   | \$—   | \$(10,276 )                          | \$(10,299 )  |
| Balance at December 31, 2013      | \$(20,419 )   | \$—   | \$(6,373 )                           | \$(26,792 )  |
| Other comprehensive income (loss) | 11,638  | (117 )  | —                                    | 11,521   |
| Balance at June 30, 2014          | \$(8,781 )  | \$(117 )  | \$(6,373 )                           | \$(15,271 )  |

See accompanying notes to the unaudited condensed consolidated financial statements.





## FIRST MIDWEST BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Amounts in thousands, except per share data)

(Unaudited)

|  | Common<br>Shares<br>Outstanding | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock | Total       |
|--|---------------------------------|-----------------|----------------------------------|----------------------|---|-------------------|-------------|
| Balance at December 31, 2012                           | 74,840                          | \$858           | \$418,318                        | \$786,453            | \$(15,660)                                    | \$(249,076)       | \$940,893   |
| Comprehensive income                                   | —                               | —               | —                                | 30,818               | 5,361   | —                 | 36,179      |
| Common dividends declared                              | —                               | —               | —                                | (3,755)              | —   | —                 | (3,755)     |
| (\$0.05 per common share)                              |                                 |                 |                                  |                      |   |                   |             |
| Share-based compensation expense                       | —                               | —               | 2,854                            | —                    | —   | —                 | 2,854       |
| Restricted stock activity                              | 224                             | —               | (9,648)                          | —                    | —   | 8,126             | (1,522)     |
| Treasury stock (purchased for)                         | (1)                             | —               | (54)                             | —                    | —   | 58                | 4           |
| issued to benefit plans                                |                                 |                 |                                  |                      |   |                   |             |
| Balance at June 30, 2013                               | 75,063                          | \$858           | \$411,470                        | \$813,516            | \$(10,299)                                    | \$(240,892)       | \$974,653   |
| Balance at December 31, 2013                           | 75,071                          | \$858           | \$414,293                        | \$853,740            | \$(26,792)                                    | \$(240,657)       | \$1,001,442 |
| Comprehensive income                                   | —                               | —               | —                                | 36,164               | 11,521  | —                 | 47,685      |
| Common dividends declared                              | —                               | —               | —                                | (11,297)             | —   | —                 | (11,297)    |
| (\$0.15 per common share)                              |                                 |                 |                                  |                      |   |                   |             |
| Share-based compensation expense                       | —                               | —               | 3,226                            | —                    | —   | —                 | 3,226       |
| Restricted stock activity                              | 194                             | —               | (9,501)                          | —                    | —   | 7,625             | (1,876)     |
| Treasury stock issued to (purchased for) benefit plans | 8                               | —               | (123)                            | —                    | —   | 381               | 258         |
| Balance at June 30, 2014                               | 75,273                          | \$858           | \$407,895                        | \$878,607            | \$(15,271)                                    | \$(232,651)       | \$1,039,438 |

See accompanying notes to the unaudited condensed consolidated financial statements.

FIRST MIDWEST BANCORP, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Dollar amounts in thousands)  
 (Unaudited)

|   | Six Months Ended |            |
|---|------------------|------------|
|   | June 30,         |            |
|   | 2014             | 2013       |
| Net cash provided by operating activities   | \$56,405         | \$70,414   |
| Investing Activities  |                  |            |
| Proceeds from maturities, prepayments, and calls of securities available-for-sale     | 82,779           | 125,533    |
| Proceeds from sales of securities available-for-sale                                  | 12,838           | 19,745     |
| Purchases of securities available-for-sale  | (11,115          | ) (289,666 |
| Proceeds from maturities, prepayments, and calls of securities held-to-maturity       | 3,151            | 5,803      |
| Purchases of securities held-to-maturity  | (1,030           | ) (1,881   |
| Net (purchases) redemption of FHLB stock  | (427             | ) 12,071   |
| Net increase in loans   | (251,586         | ) (85,210  |
| BOLI income, net of claims  | (72              | ) (76      |
| Proceeds from sales of OREO   | 9,160            | 10,907     |
| Proceeds from sales of premises, furniture, and equipment                             | 158              | 1,425      |
| Purchases of premises, furniture, and equipment                                       | (4,074           | ) (3,286   |
| Net cash used in investing activities   | (160,218         | ) (204,635 |
| Financing Activities  |                  |            |
| Net increase in deposit accounts  | 129,149          | 194,492    |
| Net (decrease) increase in borrowed funds   | (5,591           | ) 10,619   |
| Payment for the termination of FHLB advances  | (116,609         | ) —        |
| Cash dividends paid   | (10,530          | ) (1,499   |
| Restricted stock activity   | (2,699           | ) (1,588   |
| Excess tax benefit related to share-based compensation                                | 825              | 36         |
| Net cash (used in) provided by financing activities                                   | (5,455           | ) 202,060  |
| Net (decrease) increase in cash and cash equivalents                                  | (109,268         | ) 67,839   |
| Cash and cash equivalents at beginning of period                                      | 587,241          | 716,266    |
| Cash and cash equivalents at end of period  | \$477,973        | \$784,105  |
| Supplemental Disclosures of Cash Flow Information:                                    |                  |            |
| Income taxes paid (refunded)  | \$4,734          | \$(3,498   |
| Interest paid to depositors and creditors   | 11,927           | 14,281     |
| Dividends declared, but unpaid  | 6,027            | 3,005      |
| Non-cash transfers of loans to OREO   | 9,339            | 11,502     |
| Non-cash transfer of loans held-for-investment to loans held-for-sale                 | 64,881           | 1,275      |
| Non-cash transfer of an investment from other assets to securities available-for-sale | —                | 2,787      |

See accompanying notes to the unaudited condensed consolidated financial statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** – The accompanying unaudited condensed consolidated interim financial statements of First Midwest Bancorp, Inc. (the “Company”), a Delaware corporation, were prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) for quarterly reports on Form 10-Q and reflect all adjustments that management deems necessary for the fair presentation of the financial position and results of operations for the periods presented. The results of operations for the quarter and six month period ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The accounting and reporting policies of the Company and its subsidiaries conform to U.S. generally accepted accounting principles (“GAAP”) and general practices within the banking industry. The accompanying quarterly statements do not include certain information and footnote disclosures required by GAAP for complete annual financial statements. Therefore, these financial statements should be read in conjunction with the Company’s 2013 Annual Report on Form 10-K (“2013 10-K”). The Company uses the accrual basis of accounting for financial reporting purposes. Certain reclassifications were made to prior year amounts to conform to the current year presentation.

**Principles of Consolidation** – The accompanying condensed consolidated financial statements include the financial position and results of operations of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions. Assets held in a fiduciary or agency capacity are not assets of the Company or its subsidiaries and are not included in the condensed consolidated financial statements.

**Use of Estimates** – The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Although these estimates and assumptions are based on the best available information, actual results could differ from those estimates.

The accounting policies related to loans, the allowance for credit losses, the FDIC indemnification asset, and derivative financial instruments are presented below. For a summary of all other significant accounting policies, please refer to Note 1, “Summary of Significant Accounting Policies,” in the Company’s 2013 10-K.

**Loans** – Loans held-for-investment are loans that the Company intends to hold until they are paid in full and are carried at the principal amount outstanding, including certain net deferred loan origination fees. Interest income on loans is accrued based on principal amounts outstanding. Loan origination fees, commitment fees, and certain direct loan origination costs are deferred, and the net amount is amortized as a yield adjustment over the contractual life of the related loans or commitments and included in interest income. Fees related to standby letters of credit are amortized into fee income over the contractual life of the commitment. Other credit-related fees are recognized as fee income when earned. Loans held-for-sale are carried at the lower of aggregate cost or fair value and included in other assets in the Consolidated Statements of Financial Condition.

**Purchased Impaired Loans** – Purchased impaired loans include acquired loans that had evidence of credit deterioration since origination and it was probable at acquisition that the Company would not collect all contractually required principal and interest payments. Evidence of credit deterioration was evaluated using various indicators, such as past due and non-accrual status. Other key considerations included past performance of the institutions' credit underwriting standards, completeness and accuracy of credit files, maintenance of risk ratings, and age of appraisals. Lease and revolving loans do not qualify to be accounted for as purchased impaired loans. No allowance for credit losses is recorded on these loans at the acquisition date. Purchased impaired loans are recorded at fair value, and are accounted for prospectively based on estimates of expected cash flows. To estimate the fair value, the Company generally

aggregates purchased consumer loans and certain smaller balance commercial loans into pools of loans with common risk characteristics, such as delinquency status, credit score, and internal risk rating. The fair values of larger balance commercial loans are estimated on an individual basis. Expected future cash flows in excess of the fair value of loans at the purchase date (“accretable yield”) are recorded as interest income over the life of the loans if the timing and amount of the future cash flows can be reasonably estimated. The non-accretable yield represents the difference between contractually required payments and the cash flows expected to be collected at acquisition.

Subsequent increases in cash flows are recognized as interest income prospectively. The present value of any decreases in expected cash flows is recognized by recording a charge-off through the allowance for loan and covered loan losses or establishing an allowance for loan and covered loan losses.

Non-accrual Loans – Generally, corporate loans are placed on non-accrual status (i) when either principal or interest payments become 90 days or more past due unless the loan is sufficiently collateralized such that full repayment of both principal and interest is expected and is in the process of collection within a reasonable period or (ii) when an individual analysis of a borrower’s creditworthiness warrants a downgrade to non-accrual regardless of past due status. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed, and unpaid interest accrued in prior years is charged against the allowance for loan losses. After the loan is placed on non-accrual, all debt service payments are applied to the principal on the loan. Future interest income may only be recorded on a cash basis after recovery of principal is reasonably assured. Non-accrual loans are returned to accrual status when the financial position of the borrower and other relevant factors indicate that the Company will collect all principal and interest.

Commercial loans and loans secured by real estate are charged-off when deemed uncollectible. A loss is recorded if the net realizable value of the underlying collateral is less than the outstanding principal and interest. Consumer loans that are not secured by real estate are subject to mandatory charge-off at a specified delinquency date and are usually not classified as non-accrual prior to being charged-off. Closed-end consumer loans, which include installment, automobile, and single payment loans, are usually charged-off no later than the end of the month in which the loan becomes 120 days past due.

Purchased impaired loans are generally considered accruing loans unless reasonable estimates of the timing and amount of future cash flows cannot be determined. Loans without reasonable cash flow estimates are classified as non-accrual loans, and interest income is not recognized on those loans until the timing and amount of the future cash flows can be reasonably determined.

Troubled Debt Restructurings (“TDRs”) – A restructuring is considered a TDR when (i) the borrower is experiencing financial difficulties and (ii) the creditor grants a concession, such as forgiveness of principal, reduction of the interest rate, changes in payments, or extension of the maturity date. Loans are not classified as TDRs when the modification is short-term or results in an insignificant delay in payments. The Company’s TDRs are determined on a case-by-case basis.

The Company does not accrue interest on a TDR unless it believes collection of all principal and interest under the modified terms is reasonably assured. For a TDR to begin accruing interest, the borrower must demonstrate both some level of past performance and the future capacity to perform under the modified terms. Generally, six months of consecutive payment performance under the restructured terms is required before a TDR is returned to accrual status. However, the period could vary depending on the individual facts and circumstances of the loan. An evaluation of the borrower’s current creditworthiness is used to assess the borrower’s capacity to repay the loan under the modified terms. This evaluation includes an estimate of expected cash flows, evidence of strong financial position, and estimates of the value of collateral, if applicable. For TDRs to be removed from TDR status in the calendar year after the restructuring, the loans must (i) have an interest rate and terms that reflect market conditions at the time of restructuring, and (ii) be in compliance with the modified terms. If the loan was restructured at below market rates and terms, it continues to be separately reported as restructured until it is paid in full or charged-off.

Impaired Loans – Impaired loans consist of corporate non-accrual loans and TDRs.

A loan is considered impaired when it is probable that the Company will not collect all contractual principal and interest. With the exception of accruing TDRs, impaired loans are classified as non-accrual and are exclusive of smaller homogeneous loans, such as home equity, 1-4 family mortgages, and installment loans. Impaired loans with balances under a specified threshold are not individually evaluated for impairment. For all other impaired loans, impairment is measured by comparing the estimated value of the loan to the recorded book value. The value of collateral-dependent loans is based on the fair value of the underlying collateral, less costs to sell. The value of other loans is measured using the present value of expected future cash flows discounted at the loan’s initial effective interest

rate. Purchased impaired loans are not reported as impaired loans provided that estimates of the timing and amount of future cash flows can be reasonably determined.

90-Days Past Due Loans –The Company’s accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is sufficiently collateralized and in the process of renewal or collection.

Allowance for Credit Losses – The allowance for credit losses is comprised of the allowance for loan losses, the allowance for covered loan losses, and the reserve for unfunded commitments, and is maintained by management at a level believed adequate to absorb estimated losses inherent in the existing loan portfolio. Determination of the allowance for credit losses is subjective since it requires significant estimates and management judgment, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans, consideration of current economic trends, and other factors.

Loans deemed to be uncollectible are charged-off against the allowance for loan and covered loan losses, while recoveries of amounts previously charged-off are credited to the allowance for loan and covered loan losses. Additions to the allowance for loan and covered loan losses are charged to expense through the provision for loan and covered loan losses. The amount of provision

depends on a number of factors, including net charge-off levels, loan growth, changes in the composition of the loan portfolio, and the Company's assessment of the allowance for loan and covered loan losses based on the methodology discussed below.

**Allowance for Loan Losses** – The allowance for loan losses consists of (i) specific reserves for individual loans where the recorded investment exceeds the value, (ii) an allowance based on a loss migration analysis that uses historical credit loss experience for each loan category, and (iii) an allowance based on other internal and external qualitative factors.

The specific reserves component of the allowance for loan losses is based on a periodic analysis of impaired loans exceeding a fixed dollar amount. If the value of an impaired loan is less than the recorded book value, the Company either establishes a valuation allowance (i.e., a specific reserve) equal to the excess of the book value over the value of the loan as a component of the allowance for loan losses or charges off the amount if it is a confirmed loss.

The general reserve component is based on a loss migration analysis, which examines actual loss experience by loan category for a rolling 8-quarter period and the related internal risk rating for corporate loans. The loss migration analysis is updated quarterly using actual loss experience. This component is then adjusted based on management's consideration of many internal and external qualitative factors, including:

- Changes in the composition of the loan portfolio, trends in the volume of loans, and trends in delinquent and non-accrual loans that could indicate that historical trends do not reflect current conditions.
- Changes in credit policies and procedures, such as underwriting standards and collection, charge-off, and recovery practices.
- Changes in the experience, ability, and depth of credit management and other relevant staff.
- Changes in the quality of the Company's loan review system and Board of Directors oversight.
- The effect of any concentration of credit and changes in the level of concentrations, such as loan type or risk rating.
- Changes in the value of the underlying collateral for collateral-dependent loans.
- Changes in the national and local economy that affect the collectability of various segments of the portfolio.
- The effect of other external factors, such as competition and legal and regulatory requirements, on the Company's loan portfolio.

**Allowance for Covered Loan Losses** – The Company's allowance for covered loan losses reflects the difference between the carrying value and the discounted present value of the estimated cash flows of the covered purchased impaired loans. On a periodic basis, the adequacy of this allowance is determined through a re-estimation of cash flows on all of the outstanding covered purchased impaired loans using either a probability of default/loss given default ("PD/LGD") methodology or a specific review methodology. The PD/LGD model is an expected loss model that estimates future cash flows using a probability of default curve and loss given default estimates.

**Reserve for Unfunded Commitments** – The Company also maintains a reserve for unfunded commitments, including letters of credit, for the risk of loss inherent in these arrangements. The reserve for unfunded commitments is estimated using the loss migration analysis from the allowance for loan losses, adjusted for probabilities of future funding requirements. The reserve for unfunded commitments is included in other liabilities in the Consolidated Statements of Financial Condition.

The establishment of the allowance for credit losses involves a high degree of judgment given the difficulty of assessing the factors impacting loan repayment and estimating the timing and amount of losses. While management utilizes its best judgment and information available, the adequacy of the allowance for credit losses depends on a variety of factors beyond the Company's control, including the performance of its loan portfolio, the economy, changes in interest rates and property values, and the interpretation of loan risk classifications by regulatory authorities.



FDIC Indemnification Asset – The majority of loans and OREO acquired through FDIC-assisted transactions are covered by loss share agreements with the FDIC (the “FDIC Agreements”), under which the FDIC reimburses the Company for the majority of the losses and eligible expenses related to these assets. The FDIC indemnification asset represents the present value of future expected reimbursements from the FDIC. Since the indemnified items are covered loans and covered OREO, which are initially measured at fair value, the FDIC indemnification asset is also initially measured at fair value by discounting the cash flows expected to be received from the FDIC. These cash flows are estimated by multiplying estimated losses on purchased impaired loans and OREO by the reimbursement rates in the FDIC Agreements.

The balance of the FDIC indemnification asset is adjusted periodically to reflect changes in estimated cash flows. Decreases in estimated reimbursements from the FDIC are recorded prospectively through amortization and increases in estimated reimbursements from the FDIC are recognized by an increase in the carrying value of the indemnification asset. Payments from the FDIC for reimbursement of losses result in a reduction of the FDIC indemnification asset.

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Derivative Financial Instruments – In the ordinary course of business, the Company enters into derivative transactions as part of its overall interest rate risk management strategy to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. All derivative instruments are recorded at fair value as either other assets or other liabilities in the Consolidated Statements of Financial Condition. Subsequent changes in a derivative's fair value are recognized in earnings unless specific hedge accounting criteria are met.

On the date the Company enters into a derivative contract, the derivative is designated as a fair value hedge, a cash flow hedge, or a non-hedge derivative instrument. Fair value hedges are designed to mitigate exposure to changes in the fair value of an asset or liability attributable to a particular risk, such as interest rate risk. Cash flow hedges are designed to mitigate exposure to variability in expected future cash flows to be received or paid related to an asset, liability, or other type of forecasted transaction. The Company formally documents all relationships between hedging instruments and hedged items, including its risk management objective and strategy.

At the hedge's inception and quarterly thereafter, a formal assessment is performed to determine the effectiveness of the derivative in offsetting changes in the fair values or cash flows of the hedged items in the current period and prospectively. If a derivative instrument designated as a hedge is terminated or ceases to be highly effective, hedge accounting is discontinued prospectively, and the gain or loss is amortized into earnings. For fair value hedges, the gain or loss is amortized over the remaining life of the hedged asset or liability. For cash flow hedges, the gain or loss is amortized over the same period that the forecasted hedged transactions impact earnings. If the hedged item is disposed of, any fair value adjustments are included in the gain or loss from the disposition of the hedged item. If the forecasted transaction is no longer probable, the gain or loss is included in earnings immediately.

For effective fair value hedges, changes in the fair value of the derivative instruments, as well as changes in the fair value of the hedged item, are recognized in earnings. For cash flow hedges, the effective portion of the change in fair value of the derivative instrument is reported as a component of accumulated other comprehensive loss and is reclassified to earnings when the hedged transaction is reflected in earnings.

Ineffectiveness is calculated based on the change in fair value of the hedged item compared with the change in fair value of the hedging instrument. For all types of hedges, any ineffectiveness in the hedging relationship is recognized in earnings during the period the ineffectiveness occurs.

## 2. RECENT EVENTS

### Acquisitions

On April 22, 2014, First Midwest Bank (the "Bank") entered into a definitive agreement to acquire the Chicago area banking operations of Banco Popular North America (doing business as Popular Community Bank), which is a subsidiary of Popular, Inc. The acquisition includes Popular Community Bank's retail banking offices and its small business and middle market commercial lending activities in the Chicago metropolitan area. As part of the transaction, the Bank will acquire twelve full-service retail branches, approximately \$738 million in deposits, and approximately \$561 million in loans. The Bank received regulatory approval for this acquisition from the Federal Reserve; however, the acquisition is subject to certain closing conditions and is expected to close in the third quarter of 2014.

### Equity Matters

On May 21, 2014, the stockholders of the Company approved an amendment to our Restated Certificate of Incorporation. The amendment increased the Company's authorized common stock by 50,000,000 shares. Following this amendment, the Company is now authorized to issue a total of 151,000,000 shares, including 1,000,000 shares of Preferred Stock, without a par value, and 150,000,000 shares of Common Stock, \$0.01 par value per share.

### Recent Accounting Pronouncements

Income Taxes: In January of 2014, the Financial Accounting Standards Board ("FASB") issued guidance that requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date or, if the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The guidance is effective for annual and interim reporting periods beginning on or after December 15, 2013, and must be applied

prospectively. The adoption of this guidance on January 1, 2014 did not impact the Company's financial condition, results of operations, or liquidity.

**Receivables - Troubled Debt Restructurings by Creditors:** In January of 2014, the FASB issued guidance to clarify when an in substance repossession or foreclosure occurs and an entity is considered to have received physical possession of the residential real estate property such that a loan receivable should be derecognized and the real estate property recognized. Additionally, the guidance requires interim and annual disclosure of the amount of foreclosed residential real estate property held by the entity and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The guidance is effective for annual and interim periods beginning after December 15, 2014 and can be applied retrospectively or prospectively. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

**Reporting Discontinued Operations:** In April of 2014, the FASB issued guidance that requires an entity to report a disposal of a component of an entity or a group of components of an entity in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component of an entity or group of components of an entity (1) meets the criteria to be classified as held for sale, (2) is disposed of by sale, or (3) is disposed of other than by sale. The guidance is effective for annual and interim reporting periods beginning on or after December 15, 2014, and must be applied prospectively. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

**Revenue from Contracts with Customers:** In May of 2014, the FASB issued guidance that requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for annual and interim reporting periods beginning on or after December 15, 2016, and must be applied either retrospectively or using the modified retrospective approach. Management is evaluating the new guidance, but does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

**Transfers and Servicing:** In June of 2014, the FASB issued guidance that requires repurchase-to-maturity transactions to be accounted for as secured borrowings. The guidance also requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. If the derecognition criteria are met, the initial transfer will generally be accounted for as a sale and the repurchase agreement will generally be accounted for as a secured borrowing. The guidance is effective for annual and interim reporting periods beginning after December 15, 2014. Management is evaluating the new guidance, but does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

### 3. SECURITIES

Securities are classified as held-to-maturity, trading, or available-for-sale at the time of purchase. Securities classified as held-to-maturity are securities for which management has the positive intent and ability to hold to maturity and are stated at cost.

The Company's trading securities consist of diversified investment securities reported at fair value that are held in a grantor trust under deferred compensation arrangements that allow plan participants to direct amounts into a variety of securities, including Company stock. Net trading gains represent changes in the fair value of the trading securities portfolio and are included in other noninterest income in the Condensed Consolidated Statements of Income.

All other securities are classified as available-for-sale and are carried at fair value with unrealized gains and losses, net of related deferred income taxes, recorded in stockholders' equity as a separate component of accumulated other comprehensive loss.



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A summary of the Company's securities portfolio by category and maturity is presented in the following tables.

Securities Portfolio

(Dollar amounts in thousands)

|  | June 30, 2014  |             |                   |             | December 31, 2013 |             |                   |             |
|--|----------------|-------------|-------------------|-------------|-------------------|-------------|-------------------|-------------|
|  | Amortized Cost | Gross Gains | Unrealized Losses | Fair Value  | Amortized Cost    | Gross Gains | Unrealized Losses | Fair Value  |
| <b>Securities Available-for-Sale</b>                     |                |             |                   |             |                   |             |                   |             |
| U.S. agency securities                                   | \$500          | \$1         | \$—               | \$501       | \$500             | \$—         | \$—               | \$500       |
| Collateralized mortgage obligations (“CMOs”)             | 448,337        | 1,919       | (8,791 )          | 441,465     | 490,962           | 1,427       | (16,621 )         | 475,768     |
| Other mortgage-backed securities (“MBSs”)                | 123,787        | 4,429       | (724 )            | 127,492     | 135,097           | 3,349       | (2,282 )          | 136,164     |
| Municipal securities                                     | 432,187        | 13,319      | (1,621 )          | 443,885     | 457,318           | 9,673       | (5,598 )          | 461,393     |
| Trust preferred collateralized debt obligations (“CDOs”) | 45,023         | —           | (26,587 )         | 18,436      | 46,532            | —           | (28,223 )         | 18,309      |
| Corporate debt securities                                | 12,995         | 2,240       | —                 | 15,235      | 12,999            | 1,930       | —                 | 14,929      |
| <b>Equity securities:</b>                                |                |             |                   |             |                   |             |                   |             |
| Hedge fund investment                                    | 298            | 518         | —                 | 816         | 1,208             | 1,971       | —                 | 3,179       |
| Other equity securities                                  | 2,606          | 87          | (48 )             | 2,645       | 2,498             | 75          | (90 )             | 2,483       |
| Total equity securities                                  | 2,904          | 605         | (48 )             | 3,461       | 3,706             | 2,046       | (90 )             | 5,662       |
| Total available-for-sale securities                      | \$1,065,733    | \$22,513    | \$(37,771)        | \$1,050,475 | \$1,147,114       | \$18,425    | \$(52,814)        | \$1,112,725 |
| <b>Securities Held-to-Maturity</b>                       |                |             |                   |             |                   |             |                   |             |
| Municipal securities                                     | \$26,471       | \$605       | \$—               | \$27,076    | \$44,322          | \$—         | \$(935)           | \$43,387    |
| Trading Securities                                       |                |             |                   | \$18,231    |                   |             |                   | \$17,317    |

Remaining Contractual Maturity of Securities

(Dollar amounts in thousands)

|  | June 30, 2014                     |             | Held-to-Maturity |            |
|--|-----------------------------------|-------------|------------------|------------|
|  | Available-for-Sale Amortized Cost | Fair Value  | Amortized Cost   | Fair Value |
| One year or less   | \$32,269                          | \$31,437    | \$2,545          | \$2,603    |
| After one year to five years                                   | 122,919                           | 119,752     | 8,748            | 8,948      |
| After five years to ten years                                  | 187,371                           | 182,541     | 5,917            | 6,052      |
| After ten years  | 148,146                           | 144,327     | 9,261            | 9,473      |
| Securities that do not have a single contractual maturity date | 575,028                           | 572,418     | —                | —          |
| Total  | \$1,065,733                       | \$1,050,475 | \$26,471         | \$27,076   |

The carrying value of securities available-for-sale that were pledged to secure deposits or for other purposes as permitted or required by law totaled \$864.6 million at June 30, 2014 and \$755.3 million at December 31, 2013. No securities held-to-maturity were pledged as of June 30, 2014 or December 31, 2013.

Purchases and sales of securities are recognized on a trade date basis. Realized securities gains or losses are reported in net securities gains in the Condensed Consolidated Statements of Income. The cost of securities sold is based on the specific identification method. The following table presents net realized gains on securities.

Securities Gains (Losses)  
(Dollar amounts in thousands)

|   | Quarters Ended   |       | Six Months Ended |         |
|---|------------------|-------|------------------|---------|
|   | June 30,<br>2014 | 2013  | June 30,<br>2014 | 2013    |
| Gains on sales of securities:                                   |                  |       |                  |         |
| Gross realized gains  | \$4,517          | \$216 | \$5,618          | \$216   |
| Gross realized losses   | —                | —     | —                | —       |
| Net realized gains on sales of securities                       | 4,517            | 216   | 5,618            | 216     |
| Non-cash impairment charges:                                    |                  |       |                  |         |
| Other-than-temporary securities impairment ("OTTI")             | —                | —     | (28              | ) —     |
| Portion of OTTI recognized in other comprehensive income (loss) | —                | —     | —                | —       |
| Net non-cash impairment charges                                 | —                | —     | (28              | ) —     |
| Net realized gains  | \$4,517          | \$216 | \$5,590          | \$216   |
| Net trading gains <sup>(1)</sup>                                | \$531            | \$214 | \$722            | \$1,250 |

(1) All net trading gains relate to trading securities still held as of June 30, 2014 and June 30, 2013 and are included in other income in the Condensed Consolidated Statement of Income.

Net realized gains on sales of securities for the second quarter and first six months of 2014 were \$4.5 million and \$5.6 million, respectively. During the second quarter of 2014, we sold a CDO at a gain of \$3.5 million and several municipal securities at gains of \$468,000. In addition, during the first and second quarters of 2014, we sold a portion of the Company's hedge fund investment at gains of \$1.1 million and \$518,000, respectively.

The non-cash impairment charges in the table above relate to OTTI charges on certain CMOs. Accounting guidance requires that the credit portion of an OTTI charge be recognized through income. If a decline in fair value below carrying value is not attributable to credit deterioration and the Company does not intend to sell the security or believe it would not be more likely than not required to sell the security prior to recovery, the Company records the non-credit related portion of the decline in fair value in other comprehensive income (loss).

The following table presents a rollforward of life-to-date OTTI recognized in earnings related to all available-for-sale securities held by the Company for the quarters and six months ended June 30, 2014 and 2013. The majority of the beginning and ending balance of OTTI relates to CDOs currently held by the Company.

Changes in OTTI Recognized in Earnings  
(Dollar amounts in thousands)

|  | Quarters Ended   |          | Six Months Ended |          |
|--|------------------|----------|------------------|----------|
|  | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013     |
| Beginning balance                                      | \$32,450         | \$38,803 | \$32,422         | \$38,803 |
| OTTI included in earnings <sup>(1)</sup> :             |                  |          |                  |          |
| Losses on securities that previously had OTTI          | —                | —        | 28               | —        |
| Losses on securities that did not previously have OTTI | —                | —        | —                | —        |
| Reduction for sales of securities <sup>(2)</sup>       | (8,570           | ) (6,750 | ) (8,570         | ) (6,750 |
| Ending balance   | \$23,880         | \$32,053 | \$23,880         | \$32,053 |



- (1) Included in net securities gains in the Condensed Consolidated Statements of Income.  
During the second quarter of 2014, one CDO with a carrying value of \$1.3 million was sold. In addition, one CDO
- (2) with a carrying value of zero was sold during the second quarter of 2013. These CDOs had OTTI of \$8.6 million and \$6.8 million, respectively, that were previously recognized in earnings.

The following table presents the aggregate amount of unrealized losses and the aggregate related fair values of securities with unrealized losses as of June 30, 2014 and December 31, 2013.

Securities in an Unrealized Loss Position  
(Dollar amounts in thousands)

|                         | Number of Securities | Less Than 12 Months |                   | Greater Than 12 Months |                   | Total      |                   |
|-------------------------|----------------------|---------------------|-------------------|------------------------|-------------------|------------|-------------------|
|                         |                      | Fair Value          | Unrealized Losses | Fair Value             | Unrealized Losses | Fair Value | Unrealized Losses |
| As of June 30, 2014     |                      |                     |                   |                        |                   |            |                   |
| CMOs                    | 54                   | \$17,978            | \$158             | \$294,643              | \$8,633           | \$312,621  | \$8,791           |
| Other MBSs              | 13                   | 383                 | 5                 | 40,986                 | 719               | 41,369     | 724               |
| Municipal securities    | 107                  | —                   | —                 | 67,326                 | 1,621             | 67,326     | 1,621             |
| CDOs                    | 5                    | —                   | —                 | 18,436                 | 26,587            | 18,436     | 26,587            |
| Equity securities       | 1                    | —                   | —                 | 2,232                  | 48                | 2,232      | 48                |
| Total                   | 180                  | \$18,361            | \$163             | \$423,623              | \$37,608          | \$441,984  | \$37,771          |
| As of December 31, 2013 |                      |                     |                   |                        |                   |            |                   |
| CMOs                    | 67                   | \$338,064           | \$14,288          | \$57,269               | \$2,333           | \$395,333  | \$16,621          |
| Other MBSs              | 19                   | 57,311              | 2,281             | 356                    | 1                 | 57,667     | 2,282             |
| Municipal securities    | 154                  | 65,370              | 3,245             | 27,565                 | 2,353             | 92,935     | 5,598             |
| CDOs                    | 6                    | —                   | —                 | 18,309                 | 28,223            | 18,309     | 28,223            |
| Equity securities       | 1                    | 2,168               | 90                | —                      | —                 | 2,168      | 90                |
| Total                   | 247                  | \$462,913           | \$19,904          | \$103,499              | \$32,910          | \$566,412  | \$52,814          |

Substantially all of the Company's CMOs and other MBSs are either backed by U.S. government-owned agencies or issued by U.S. government-sponsored enterprises. Municipal securities are issued by municipal authorities, and the majority are supported by third party insurance or some other form of credit enhancement. Management does not believe any individual unrealized loss as of June 30, 2014 represents an OTTI related to credit deterioration. The unrealized losses associated with these securities are not believed to be attributed to credit quality, but rather to changes in interest rates and temporary market movements. In addition, the Company does not intend to sell the securities with unrealized losses, and it is not more likely than not that the Company will be required to sell them before recovery of their amortized cost basis, which may be at maturity.

The unrealized losses on CDOs as of June 30, 2014 reflect the illiquidity of these structured investment vehicles. Management does not believe these unrealized losses represent OTTI related to credit deterioration. In addition, the Company does not intend to sell the CDOs with unrealized losses within a short period of time, and the Company does not believe it is more likely than not that it will be required to sell them before recovery of their amortized cost basis, which may be at maturity.

Significant judgment is required to calculate the fair value of the CDOs, all of which are pooled. The Company estimates the fair value of these securities using discounted cash flow analyses with the assistance of a structured credit valuation firm. For additional discussion of the CDO valuation methodology, refer to Note 11, "Fair Value."

## 4. LOANS

## Loans Held-for-Investment

The following table presents the Company's loans held-for-investment by class.

## Loan Portfolio

(Dollar amounts in thousands)

|   | June 30,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| Commercial and industrial                         | \$2,073,018      | \$1,830,638          |
| Agricultural                                      | 330,626          | 321,702              |
| Commercial real estate:                           |                  |                      |
| Office, retail, and industrial                    | 1,312,401        | 1,353,685            |
| Multi-family                                      | 350,430          | 332,873              |
| Construction                                      | 195,109          | 186,197              |
| Other commercial real estate                      | 798,324          | 807,071              |
| Total commercial real estate                      | 2,656,264        | 2,679,826            |
| Total corporate loans                             | 5,059,908        | 4,832,166            |
| Home equity                                       | 485,085          | 427,020              |
| 1-4 family mortgages                              | 241,156          | 275,992              |
| Installment                                       | 57,308           | 44,827               |
| Total consumer loans                              | 783,549          | 747,839              |
| Total loans, excluding covered loans              | 5,843,457        | 5,580,005            |
| Covered loans <sup>(1)</sup>                      | 104,867          | 134,355              |
| Total loans                                       | \$5,948,324      | \$5,714,360          |
| Deferred loan fees included in total loans        | \$4,051          | \$4,656              |
| Overdrawn demand deposits included in total loans | 3,980            | 5,047                |

<sup>(1)</sup> For information on covered loans, refer to Note 5, "Acquired Loans."

The Company primarily lends to community-based and mid-sized businesses, commercial real estate customers, and consumers in its markets. Within these areas, the Company diversifies its loan portfolio by loan type, industry, and borrower.

It is the Company's policy to review each prospective credit to determine the appropriateness and the adequacy of security or collateral prior to making a loan. In the event of borrower default, the Company seeks recovery in compliance with state lending laws, the Company's lending standards, and credit monitoring and remediation procedures. A discussion of risk characteristics relevant to each portfolio segment is presented in Note 4, "Loans," in the Company's 2013 10-K.

## Loan Sales

The table below summarizes the Company's loan sales for the quarter and six months ended June 30, 2014 and 2013.

## Loan Sales

(Dollar amounts in thousands)

|  | Quarters Ended   |          | Six Months Ended |          |
|--|------------------|----------|------------------|----------|
|  | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013     |
| 1-4 family mortgage loans                  |                  |          |                  |          |
| Proceeds from sales                        | \$33,038         | \$29,084 | \$84,938         | \$85,007 |
| Less book value of loans sold:             |                  |          |                  |          |
| Loans originated with intent to sell       | 20,477           | 322      | 35,935           | 322      |
| Loans held-for-investment                  | 11,713           | 27,722   | 47,082           | 81,679   |
| Total book value of loans sold             | 32,190           | 28,044   | 83,017           | 82,001   |
| Net gains on sales of 1-4 family mortgages | \$848            | \$1,040  | \$1,921          | \$3,006  |

The Company retained servicing responsibilities for a portion of the 1-4 family mortgage loans sold and collects servicing fees equal to a percentage of the outstanding principal balance. The Company also retained limited recourse for credit losses on the sold loans. A description of the recourse obligation is presented in Note 10, "Commitments, Guarantees, and Contingent Liabilities."

## 5. ACQUIRED LOANS

Since 2009, the Company acquired the majority of the assets and assumed the deposits of four financial institutions in FDIC-assisted transactions. In three of those transactions, most loans and OREO acquired are covered by the FDIC Agreements. The significant accounting policies related to purchased impaired loans and the related FDIC indemnification asset are presented in Note 1, "Summary of Significant Accounting Policies."

## Acquired Loans

(Dollar amounts in thousands)

|                            | June 30, 2014 |             |           | December 31, 2013 |             |           |
|----------------------------|---------------|-------------|-----------|-------------------|-------------|-----------|
|                            | Covered       | Non-Covered | Total     | Covered           | Non-Covered | Total     |
| Purchased impaired loans   | \$75,864      | \$13,914    | \$89,778  | \$103,525         | \$15,608    | \$119,133 |
| Other loans <sup>(1)</sup> | 29,003        | 14,075      | 43,078    | 30,830            | 17,024      | 47,854    |
| Total acquired loans       | \$104,867     | \$27,989    | \$132,856 | \$134,355         | \$32,632    | \$166,987 |

<sup>(1)</sup> These loans did not meet the criteria to be accounted for as purchased impaired loans.

In connection with the FDIC Agreements, the Company recorded an indemnification asset. To maintain eligibility for the loss share reimbursement, the Company is required to follow certain servicing procedures as specified in the FDIC Agreements. The Company was in compliance with those requirements as of June 30, 2014 and December 31, 2013.

## Changes in the FDIC Indemnification Asset

(Dollar amounts in thousands)

|   | Quarters Ended   |          | Six Months Ended |          |
|---|------------------|----------|------------------|----------|
|   | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013     |
| Beginning balance   | \$15,537         | \$28,958 | \$16,585         | \$37,051 |
| Amortization  | (818)            | (908)    | (2,134)          | (2,232)  |
| Change in expected reimbursements from the FDIC for changes in expected credit losses | (629)            | (1,512)  | 532              | (2,454)  |
| Payments received from the FDIC   | (3,814)          | (3,380)  | (4,707)          | (9,207)  |
| Ending balance  | \$10,276         | \$23,158 | \$10,276         | \$23,158 |

Changes in the accretable yield for purchased impaired loans were as follows.

## Changes in Accretable Yield

(Dollar amounts in thousands)

|                      | Quarters Ended   |          | Six Months Ended |          |
|----------------------|------------------|----------|------------------|----------|
|                      | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013     |
| Beginning balance    | \$32,010         | \$45,532 | \$36,792         | \$51,498 |
| Accretion            | (3,421)          | (4,456)  | (6,931)          | (8,342)  |
| Other <sup>(1)</sup> | 6,563            | 6,028    | 5,291            | 3,948    |
| Ending balance       | \$35,152         | \$47,104 | \$35,152         | \$47,104 |

<sup>(1)</sup> Amount represents an increase in the estimated cash flows to be collected over the remaining estimated life of the underlying portfolio.



## 6. PAST DUE LOANS, ALLOWANCE FOR CREDIT LOSSES, IMPAIRED LOANS, AND TDRS

## Past Due and Non-accrual Loans

The following table presents an aging analysis of the Company's past due loans as of June 30, 2014 and December 31, 2013. The aging is determined without regard to accrual status. The table also presents non-performing loans, consisting of non-accrual loans (the majority of which are past due) and loans 90 days or more past due and still accruing interest, as of each balance sheet date.

Aging Analysis of Past Due Loans and Non-Performing Loans by Class  
(Dollar amounts in thousands)

|                                      | Aging Analysis (Accruing and Non-accrual) |                           |                                   |                   | Non-performing Loans |                          |  |
|--------------------------------------|---|---------------------------|-----------------------------------|-------------------|----------------------|--------------------------|--|
|                                      | Current                                   | 30-89<br>Days<br>Past Due | 90 Days<br>or<br>More Past<br>Due | Total<br>Past Due | Total<br>Loans       | Non-<br>accrual<br>Loans | 90 Days<br>Past Due<br>Loans,<br>Still<br>Accruing<br>Interest |
| June 30, 2014                        |   |                           |                                   |                   |                      |                          |  |
| Commercial and industrial            | \$2,059,868                               | \$8,003                   | \$5,147                           | \$13,150          | \$2,073,018          | \$22,629                 | \$2,207  |
| Agricultural                         | 330,207                                   | 86                        | 333                               | 419               | 330,626              | 363                      | —  |
| Commercial real estate:              |   |                           |                                   |                   |                      |                          |  |
| Office, retail, and industrial       | 1,293,378                                 | 5,459                     | 13,564                            | 19,023            | 1,312,401            | 16,423                   | —  |
| Multi-family                         | 348,353                                   | 625                       | 1,452                             | 2,077             | 350,430              | 1,572                    | 231  |
| Construction                         | 187,761                                   | 2,271                     | 5,077                             | 7,348             | 195,109              | 5,077                    | —  |
| Other commercial real estate         | 787,292                                   | 4,007                     | 7,025                             | 11,032            | 798,324              | 7,930                    | 676  |
| Total commercial real estate         | 2,616,784                                 | 12,362                    | 27,118                            | 39,480            | 2,656,264            | 31,002                   | 907  |
| Total corporate loans                | 5,006,859                                 | 20,451                    | 32,598                            | 53,049            | 5,059,908            | 53,994                   | 3,114  |
| Home equity                          | 476,287                                   | 3,646                     | 5,152                             | 8,798             | 485,085              | 6,580                    | 91   |
| 1-4 family mortgages                 | 235,829                                   | 2,102                     | 3,225                             | 5,327             | 241,156              | 4,091                    | 297  |
| Installment                          | 54,840                                    | 382                       | 2,086                             | 2,468             | 57,308               | 2,063                    | 31   |
| Total consumer loans                 | 766,956                                   | 6,130                     | 10,463                            | 16,593            | 783,549              | 12,734                   | 419  |
| Total loans, excluding covered loans | 5,773,815                                 | 26,581                    | 43,061                            | 69,642            | 5,843,457            | 66,728                   | 3,533  |
| Covered loans                        | 78,725                                    | 6,286                     | 19,856                            | 26,142            | 104,867              | 13,060                   | 8,464  |
| Total loans                          | \$5,852,540                               | \$32,867                  | \$62,917                          | \$95,784          | \$5,948,324          | \$79,788                 | \$11,997   |
| December 31, 2013                    |   |                           |                                   |                   |                      |                          |  |
| Commercial and industrial            | \$1,814,660                               | \$6,872                   | \$9,106                           | \$15,978          | \$1,830,638          | \$11,767                 | \$393  |
| Agricultural                         | 321,156                                   | 134                       | 412                               | 546               | 321,702              | 519                      | —  |
| Commercial real estate:              |   |                           |                                   |                   |                      |                          |  |
| Office, retail, and industrial       | 1,335,027                                 | 2,620                     | 16,038                            | 18,658            | 1,353,685            | 17,076                   | 1,315  |
| Multi-family                         | 330,960                                   | 318                       | 1,595                             | 1,913             | 332,873              | 1,848                    | —  |
| Construction                         | 180,083                                   | 23                        | 6,091                             | 6,114             | 186,197              | 6,297                    | —  |
| Other commercial real estate         | 795,462                                   | 5,365                     | 6,244                             | 11,609            | 807,071              | 8,153                    | 258  |
| Total commercial real estate         | 2,641,532                                 | 8,326                     | 29,968                            | 38,294            | 2,679,826            | 33,374                   | 1,573  |
| Total corporate loans                | 4,777,348                                 | 15,332                    | 39,486                            | 54,818            | 4,832,166            | 45,660                   | 1,966  |

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|                                      |             |          |          |           |             |          |          |
|--------------------------------------|-------------|----------|----------|-----------|-------------|----------|----------|
| Home equity                          | 415,791     | 4,830    | 6,399    | 11,229    | 427,020     | 6,864    | 1,102    |
| 1-4 family mortgages                 | 268,912     | 2,046    | 5,034    | 7,080     | 275,992     | 5,198    | 548      |
| Installment                          | 42,350      | 330      | 2,147    | 2,477     | 44,827      | 2,076    | 92       |
| Total consumer loans                 | 727,053     | 7,206    | 13,580   | 20,786    | 747,839     | 14,138   | 1,742    |
| Total loans, excluding covered loans | 5,504,401   | 22,538   | 53,066   | 75,604    | 5,580,005   | 59,798   | 3,708    |
| Covered loans                        | 94,211      | 2,232    | 37,912   | 40,144    | 134,355     | 20,942   | 18,081   |
| Total loans                          | \$5,598,612 | \$24,770 | \$90,978 | \$115,748 | \$5,714,360 | \$80,740 | \$21,789 |

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## Allowance for Credit Losses

The Company maintains an allowance for credit losses at a level deemed adequate by management to absorb probable losses inherent in the loan portfolio. Refer to Note 1, "Summary of Significant Accounting Policies," for the accounting policy for the allowance for credit losses. A rollforward of the allowance for credit losses by portfolio segment for the quarters and six months ended June 30, 2014 and 2013 is presented in the table below.

## Allowance for Credit Losses by Portfolio Segment

(Dollar amounts in thousands)

|  | Commercial<br>Industrial,<br>and<br>Agricultural | Office,<br>Retail,<br>and<br>Industrial | Multi-<br>Family | Construction | Other<br>Commercial<br>Real<br>Estate | Consumer  | Covered<br>Loans | Reserve<br>for<br>Unfunded<br>Commitments | Total<br>Allowance |
|--|--|---|------------------|--------------|---------------------------------------|-----------|------------------|---|--------------------|
| Quarter ended June 30,<br>2014                       |  |   |                  |              |                                       |           |                  |   |                    |
| Beginning balance                                    | \$ 27,292  | \$ 13,106                               | \$ 1,968         | \$ 5,656     | \$ 9,236                              | \$ 11,945 | \$ 11,429        | \$ 1,616                                  | \$ 82,248          |
| Charge-offs  | (2,099 )   | (3,511 )                                | (267 )           | (234 )       | (561 )                                | (1,828 )  | (279 )           | —   | (8,779 )           |
| Recoveries   | 259  | 290                                     | 2                | 2            | 89                                    | 213       | 277              | —   | 1,132              |
| Net charge-offs                                      | (1,840 )   | (3,221 )                                | (265 )           | (232 )       | (472 )                                | (1,615 )  | (2 )             | —   | (7,647 )           |
| Provision for loan and covered loan losses and other | 3,742  | 1,946                                   | 345              | (539 )       | (179 )                                | 2,110     | (2,084 )         | —   | 5,341              |
| Ending balance                                       | \$ 29,194  | \$ 11,831                               | \$ 2,048         | \$ 4,885     | \$ 8,585                              | \$ 12,440 | \$ 9,343         | \$ 1,616                                  | \$ 79,942          |
| Quarter ended June 30,<br>2013                       |  |   |                  |              |                                       |           |                  |   |                    |
| Beginning balance                                    | \$ 36,544  | \$ 10,695                               | \$ 3,704         | \$ 4,667     | \$ 17,757                             | \$ 11,997 | \$ 12,227        | \$ 2,866                                  | \$ 100,457         |
| Charge-offs  | (3,116 )   | (1,453 )                                | (213 )           | (850 )       | (547 )                                | (2,523 )  | (1,980 )         | —   | (10,682 )          |
| Recoveries   | 573  | 35                                      | 30               | 5            | 329                                   | 413       | 3                | —   | 1,388              |
| Net charge-offs                                      | (2,543 )   | (1,418 )                                | (183 )           | (845 )       | (218 )                                | (2,110 )  | (1,977 )         | —   | (9,294 )           |
| Provision for loan and covered loan losses and other | (2,259 )   | 2,580                                   | (97 )            | 348          | (1,370 )                              | 2,480     | 4,131            | —   | 5,813              |
| Ending balance                                       | \$ 31,742  | \$ 11,857                               | \$ 3,424         | \$ 4,170     | \$ 16,169                             | \$ 12,367 | \$ 14,381        | \$ 2,866                                  | \$ 96,976          |
| Six months ended June 30, 2014                       |  |   |                  |              |                                       |           |                  |   |                    |
| Beginning balance                                    | \$ 30,381  | \$ 10,405                               | \$ 2,017         | \$ 6,316     | \$ 10,817                             | \$ 13,010 | \$ 12,559        | \$ 1,616                                  | \$ 87,121          |
| Charge-offs  | (5,779 )   | (4,594 )                                | (357 )           | (895 )       | (2,332 )                              | (3,856 )  | (524 )           | —   | (18,337 )          |
| Recoveries   | 2,419  | 348                                     | 3                | 160          | 233                                   | 351       | 862              | —   | 4,376              |
| Net charge-offs                                      | (3,360 )   | (4,246 )                                | (354 )           | (735 )       | (2,099 )                              | (3,505 )  | 338              | —   | (13,961 )          |
| Provision for loan                                   | 2,173  | 5,672                                   | 385              | (696 )       | (133 )                                | 2,935     | (3,554 )         | —   | 6,782              |

|   |           |           |          |          |           |           |           |          |            |
|---|-----------|-----------|----------|----------|-----------|-----------|-----------|----------|------------|
| and covered<br>loan<br>losses and<br>other                          |           |           |          |          |           |           |           |          |            |
| Ending balance  | \$ 29,194 | \$ 11,831 | \$ 2,048 | \$ 4,885 | \$ 8,585  | \$ 12,440 | \$ 9,343  | \$ 1,616 | \$ 79,942  |
| Six months ended June 30, 2013                                      |           |           |          |          |           |           |           |          |            |
| Beginning<br>balance  | \$ 36,761 | \$ 11,432 | \$ 3,575 | \$ 5,242 | \$ 17,512 | \$ 12,862 | \$ 12,062 | \$ 3,366 | \$ 102,812 |
| Charge-offs   | (6,291 )  | (2,715 )  | (378 )   | (1,415 ) | (3,082 )  | (4,887 )  | (2,686 )  | —        | (21,454 )  |
| Recoveries  | 2,662     | 37        | 35       | 5        | 1,361     | 520       | 11        | —        | 4,631      |
| Net charge-offs   | (3,629 )  | (2,678 )  | (343 )   | (1,410 ) | (1,721 )  | (4,367 )  | (2,675 )  | —        | (16,823 )  |
| Provision for<br>loan<br>and covered<br>loan<br>losses and<br>other | (1,390 )  | 3,103     | 192      | 338      | 378       | 3,872     | 4,994     | (500 )   | 10,987     |
| Ending balance  | \$ 31,742 | \$ 11,857 | \$ 3,424 | \$ 4,170 | \$ 16,169 | \$ 12,367 | \$ 14,381 | \$ 2,866 | \$ 96,976  |

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The table below provides a breakdown of loans and the related allowance for credit losses by portfolio segment as of June 30, 2014 and December 31, 2013.

Loans and Related Allowance for Credit Losses by Portfolio Segment  
(Dollar amounts in thousands)

|  | Loans  |  |                       |             | Allowance for Credit Losses                    |  |                       |          |
|--|--|--|-----------------------|-------------|--|--|-----------------------|----------|
|  | Individually<br>Evaluated<br>for<br>Impairment | Collectively<br>Evaluated<br>for<br>Impairment | Purchased<br>Impaired | Total       | Individually<br>Evaluated<br>for<br>Impairment | Collectively<br>Evaluated<br>for<br>Impairment | Purchased<br>Impaired | Total    |
| June 30, 2014  |  |  |                       |             |  |  |                       |          |
| Commercial,<br>industrial, and<br>agricultural<br>Commercial real<br>estate: | \$21,726                                       | \$2,380,505                                    | \$1,413               | \$2,403,644 | \$2,539  | \$26,655                                       | \$—                   | \$29,194 |
| Office, retail, and<br>industrial  | 15,605   | 1,296,796                                      | —                     | 1,312,401   | 1,576  | 10,255   | —                     | 11,831   |
| Multi-family   | 1,169  | 349,129  | 132                   | 350,430     | 176  | 1,857  | 15                    | 2,048    |
| Construction   | 4,725  | 190,384  | —                     | 195,109     | 373  | 4,512  | —                     | 4,885    |
| Other commercial real<br>estate  | 5,748  | 789,203  | 3,373                 | 798,324     | 913  | 7,672  | —                     | 8,585    |
| Total commercial<br>real estate  | 27,247   | 2,625,512                                      | 3,505                 | 2,656,264   | 3,038  | 24,296   | 15                    | 27,349   |
| Total corporate loans  | 48,973   | 5,006,017                                      | 4,918                 | 5,059,908   | 5,577  | 50,951   | 15                    | 56,543   |
| Consumer   | —  | 774,553  | 8,996                 | 783,549     | —  | 11,887   | 553                   | 12,440   |
| Total loans, excluding<br>covered loans                                      | 48,973   | 5,780,570                                      | 13,914                | 5,843,457   | 5,577  | 62,838   | 568                   | 68,983   |
| Covered loans:   |  |  |                       |             |  |  |                       |          |
| Purchased impaired<br>loans  | —  | —  | 75,864                | 75,864      | —  | —  | 8,743                 | 8,743    |
| Other loans  | —  | 29,003   | —                     | 29,003      | —  | 600  | —                     | 600      |
| Total covered loans  | —  | 29,003   | 75,864                | 104,867     | —  | 600  | 8,743                 | 9,343    |
| Reserve for unfunded<br>commitments  | —  | —  | —                     | —           | —  | 1,616  | —                     | 1,616    |
| Total loans  | \$48,973                                       | \$5,809,573                                    | \$89,778              | \$5,948,324 | \$5,577  | \$65,054                                       | \$9,311               | \$79,942 |
| December 31, 2013  |  |  |                       |             |  |  |                       |          |
| Commercial,<br>industrial, and<br>agricultural<br>Commercial real<br>estate: | \$13,178                                       | \$2,137,440                                    | \$1,722               | \$2,152,340 | \$4,046  | \$26,335                                       | \$—                   | \$30,381 |
| Office, retail, and<br>industrial  | 26,348   | 1,327,337                                      | —                     | 1,353,685   | 214  | 10,191   | —                     | 10,405   |
| Multi-family   | 1,296  | 331,445  | 132                   | 332,873     | 18   | 1,999  | —                     | 2,017    |
| Construction   | 5,712  | 180,485  | —                     | 186,197     | 178  | 6,138  | —                     | 6,316    |
| Other commercial real<br>estate  | 9,298  | 793,703  | 4,070                 | 807,071     | 704  | 10,113   | —                     | 10,817   |
| Total commercial<br>real estate  | 42,654   | 2,632,970                                      | 4,202                 | 2,679,826   | 1,114  | 28,441   | —                     | 29,555   |

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|                                      |          |             |           |             |         |          |          |          |
|--------------------------------------|----------|-------------|-----------|-------------|---------|----------|----------|----------|
| Total corporate loans                | 55,832   | 4,770,410   | 5,924     | 4,832,166   | 5,160   | 54,776   | —        | 59,936   |
| Consumer                             | —        | 738,155     | 9,684     | 747,839     | —       | 13,010   | —        | 13,010   |
| Total loans, excluding covered loans | 55,832   | 5,508,565   | 15,608    | 5,580,005   | 5,160   | 67,786   | —        | 72,946   |
| Covered loans:                       |          |             |           |             |         |          |          |          |
| Purchased impaired loans             | —        | —           | 103,525   | 103,525     | —       | —        | 11,857   | 11,857   |
| Other loans                          | —        | 30,830      | —         | 30,830      | —       | 702      | —        | 702      |
| Total covered loans                  | —        | 30,830      | 103,525   | 134,355     | —       | 702      | 11,857   | 12,559   |
| Reserve for unfunded commitments     | —        | —           | —         | —           | —       | 1,616    | —        | 1,616    |
| Total loans                          | \$55,832 | \$5,539,395 | \$119,133 | \$5,714,360 | \$5,160 | \$70,104 | \$11,857 | \$87,121 |

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## Loans Individually Evaluated for Impairment

The following table presents loans individually evaluated for impairment by class of loan as of June 30, 2014 and December 31, 2013. Purchased impaired loans are excluded from this disclosure.

## Impaired Loans Individually Evaluated by Class

(Dollar amounts in thousands)

|  | June 30, 2014       |            |           |          | December 31, 2013   |            |           |          |
|--|---------------------|------------|-----------|----------|---------------------|------------|-----------|----------|
|  | Recorded Investment |            |           |          | Recorded Investment |            |           |          |
|  | In                  |            |           |          | In                  |            |           |          |
|  | Loans               | Loans      | Unpaid    | Specific | Loans               | Loans      | Unpaid    | Specific |
|  | with                | with       | Principal | Reserve  | with                | with       | Principal | Reserve  |
|  | No                  | a Specific | Balance   |          | No                  | a Specific | Balance   |          |
|  | Specific            | Reserve    |           |          | Specific            | Reserve    |           |          |
|  | Reserve             |            |           |          | Reserve             |            |           |          |
| Commercial and industrial                                  | \$3,381             | \$18,345   | \$38,524  | \$2,539  | \$10,047            | \$3,131    | \$25,887  | \$4,046  |
| Agricultural   | —                   | —          | —         | —        | —                   | —          | —         | —        |
| Commercial real estate:                                    |                     |            |           |          |                     |            |           |          |
| Office, retail, and industrial                             | 12,943              | 2,662      | 24,416    | 1,576    | 23,872              | 2,476      | 35,868    | 214      |
| Multi-family   | 668                 | 501        | 1,270     | 176      | 1,098               | 198        | 1,621     | 18       |
| Construction   | 3,552               | 1,173      | 6,121     | 373      | 4,586               | 1,126      | 10,037    | 178      |
| Other commercial real estate                               | 2,996               | 2,752      | 8,891     | 913      | 7,553               | 1,745      | 11,335    | 704      |
| Total commercial real estate                               | 20,159              | 7,088      | 40,698    | 3,038    | 37,109              | 5,545      | 58,861    | 1,114    |
| Total impaired loans individually evaluated for impairment | \$23,540            | \$25,433   | \$79,222  | \$5,577  | \$47,156            | \$8,676    | \$84,748  | \$5,160  |

The average recorded investment and interest income recognized on impaired loans by class for the quarters and six months ended June 30, 2014 and 2013 is presented in the following table.

Average Recorded Investment and Interest Income Recognized on Impaired Loans by Class  
(Dollar amounts in thousands)

|                                | Quarters Ended June 30,<br>2014   |   | 2013                              |   |
|--------------------------------|-----------------------------------|---|-----------------------------------|---|
|                                | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized <sup>(1)</sup> | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized <sup>(1)</sup> |
| Commercial and industrial      | \$14,581                          | \$29  | \$25,757                          | \$1   |
| Agricultural                   | —                                 | —   | —                                 | —   |
| Commercial real estate:        |                                   |   |                                   |   |
| Office, retail, and industrial | 20,098                            | 6   | 23,662                            | 6   |
| Multi-family                   | 1,424                             | 2   | 1,009                             | —   |
| Construction                   | 4,788                             | —   | 6,397                             | —   |
| Other commercial real estate   | 6,393                             | 107   | 13,762                            | 5   |
| Total commercial real estate   | 32,703                            | 115   | 44,830                            | 11  |
| Total impaired loans           | \$47,284                          | \$144   | \$70,587                          | \$12  |
|                                |                                   |   |                                   |   |
|                                | Six Months Ended June 30,<br>2014 |   | 2013                              |   |
|                                | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized <sup>(1)</sup> | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized <sup>(1)</sup> |
| Commercial and industrial      | \$14,113                          | \$147   | \$24,429                          | \$3   |
| Agricultural                   | —                                 | —   | —                                 | —   |
| Commercial real estate:        |                                   |   |                                   |   |
| Office, retail, and industrial | 22,181                            | 147   | 22,316                            | 10  |
| Multi-family                   | 1,381                             | 2   | 845                               | —   |
| Construction                   | 5,096                             | —   | 5,850                             | —   |
| Other commercial real estate   | 7,361                             | 115   | 13,353                            | 8   |
| Total commercial real estate   | 36,019                            | 264   | 42,364                            | 18  |
| Total impaired loans           | \$50,132                          | \$411   | \$66,793                          | \$21  |

<sup>(1)</sup> Recorded using the cash basis of accounting.

## Credit Quality Indicators

Corporate loans and commitments are assessed for credit risk and assigned ratings based on various characteristics, such as the borrower's cash flow, leverage, and collateral. Ratings for commercial credits are reviewed periodically. The following tables present credit quality indicators by class for corporate and consumer loans, excluding covered loans, as of June 30, 2014 and December 31, 2013.

## Corporate Credit Quality Indicators by Class, Excluding Covered Loans

(Dollar amounts in thousands)

|                                | Pass        | Special<br>Mention <sup>(1)</sup> <sup>(4)</sup> | Substandard <sup>(2)</sup><br><sup>(4)</sup> | Non-accrual <sup>(3)</sup> | Total       |
|--------------------------------|-------------|--|--|----------------------------|-------------|
| June 30, 2014                  |             |  |  |                            |             |
| Commercial and industrial      | \$1,980,523 | \$50,036   | \$19,830                                     | \$22,629                   | \$2,073,018 |
| Agricultural                   | 329,965     | 298  | —  | 363                        | 330,626     |
| Commercial real estate:        |             |  |  |                            |             |
| Office, retail, and industrial | 1,250,914   | 24,233   | 20,831                                       | 16,423                     | 1,312,401   |
| Multi-family                   | 344,279     | 3,862  | 717  | 1,572                      | 350,430     |
| Construction                   | 164,789     | 8,790  | 16,453                                       | 5,077                      | 195,109     |
| Other commercial real estate   | 758,821     | 16,218   | 15,355                                       | 7,930                      | 798,324     |
| Total commercial real estate   | 2,518,803   | 53,103   | 53,356                                       | 31,002                     | 2,656,264   |
| Total corporate loans          | \$4,829,291 | \$103,437  | \$73,186                                     | \$53,994                   | \$5,059,908 |
| December 31, 2013              |             |  |  |                            |             |
| Commercial and industrial      | \$1,780,194 | \$23,806   | \$14,871                                     | \$11,767                   | \$1,830,638 |
| Agricultural                   | 320,839     | 344  | —  | 519                        | 321,702     |
| Commercial real estate:        |             |  |  |                            |             |
| Office, retail, and industrial | 1,284,394   | 28,677   | 23,538                                       | 17,076                     | 1,353,685   |
| Multi-family                   | 326,901     | 3,214  | 910  | 1,848                      | 332,873     |
| Construction                   | 153,949     | 8,309  | 17,642                                       | 6,297                      | 186,197     |
| Other commercial real estate   | 761,465     | 14,877   | 22,576                                       | 8,153                      | 807,071     |
| Total commercial real estate   | 2,526,709   | 55,077   | 64,666                                       | 33,374                     | 2,679,826   |
| Total corporate loans          | \$4,627,742 | \$79,227   | \$79,537                                     | \$45,660                   | \$4,832,166 |

(1) Loans categorized as special mention exhibit potential weaknesses that require the close attention of management since these potential weaknesses may result in the deterioration of repayment prospects in the future.

(2) Loans categorized as substandard exhibit a well-defined weakness or weaknesses that may jeopardize the liquidation of the debt. These loans continue to accrue interest because they are well secured and collection of principal and interest is expected within a reasonable time.

(3) Loans categorized as non-accrual exhibit a well-defined weakness or weaknesses that may jeopardize the liquidation of the debt or result in a loss if the deficiencies are not corrected.

(4) Total special mention and substandard loans includes accruing TDRs of \$3.6 million as of June 30, 2014 and \$2.8 million as of December 31, 2013.

Consumer Credit Quality Indicators by Class, Excluding Covered Loans  
(Dollar amounts in thousands)

|                      | Performing | Non-accrual | Total     |
|----------------------|------------|-------------|-----------|
| June 30, 2014        |            |             |           |
| Home equity          | \$478,505  | \$6,580     | \$485,085 |
| 1-4 family mortgages | 237,065    | 4,091       | 241,156   |
| Installment          | 55,245     | 2,063       | 57,308    |
| Total consumer loans | \$770,815  | \$12,734    | \$783,549 |
| December 31, 2013    |            |             |           |
| Home equity          | \$420,156  | \$6,864     | \$427,020 |
| 1-4 family mortgages | 270,794    | 5,198       | 275,992   |
| Installment          | 42,751     | 2,076       | 44,827    |
| Total consumer loans | \$733,701  | \$14,138    | \$747,839 |

TDRs

TDRs are generally performed at the request of the individual borrower and may include forgiveness of principal, reduction in interest rates, changes in payments, and maturity date extensions. The table below presents TDRs by class as of June 30, 2014 and December 31, 2013. A discussion of our accounting policies for TDRs can be found in Note 1, "Summary of Significant Accounting Policies."

TDRs by Class

(Dollar amounts in thousands)

|                                | As of June 30, 2014 |                            |         | As of December 31, 2013 |                            |          |
|--------------------------------|---------------------|----------------------------|---------|-------------------------|----------------------------|----------|
|                                | Accruing            | Non-accrual <sup>(1)</sup> | Total   | Accruing                | Non-accrual <sup>(1)</sup> | Total    |
| Commercial and industrial      | \$2,724             | \$277                      | \$3,001 | \$6,538                 | \$2,121                    | \$8,659  |
| Agricultural                   | —                   | —                          | —       | —                       | —                          | —        |
| Commercial real estate:        |                     |                            |         |                         |                            |          |
| Office, retail, and industrial | 178                 | —                          | 178     | 10,271                  | —                          | 10,271   |
| Multi-family                   | 620                 | 242                        | 862     | 1,038                   | 253                        | 1,291    |
| Construction                   | —                   | —                          | —       | —                       | —                          | —        |
| Other commercial real estate   | 448                 | 188                        | 636     | 4,326                   | 291                        | 4,617    |
| Total commercial real estate   | 1,246               | 430                        | 1,676   | 15,635                  | 544                        | 16,179   |
| Total corporate loans          | 3,970               | 707                        | 4,677   | 22,173                  | 2,665                      | 24,838   |
| Home equity                    | 836                 | 517                        | 1,353   | 787                     | 512                        | 1,299    |
| 1-4 family mortgages           | 891                 | 476                        | 1,367   | 810                     | 906                        | 1,716    |
| Installment                    | —                   | —                          | —       | —                       | —                          | —        |
| Total consumer loans           | 1,727               | 993                        | 2,720   | 1,597                   | 1,418                      | 3,015    |
| Total loans                    | \$5,697             | \$1,700                    | \$7,397 | \$23,770                | \$4,083                    | \$27,853 |

<sup>(1)</sup> These TDRs are included in non-accrual loans in the preceding tables.

TDRs are included in the calculation of the allowance for credit losses in the same manner as impaired loans. There were no specific reserves related to TDRs as of June 30, 2014 and there were \$2.0 million in specific reserves related to TDRs as of December 31, 2013.





During the quarter and six months ended June 30, 2014, there were no material loans that were restructured. The following table presents a summary of loans that were restructured during the quarter and six months ended June 30, 2013.

Loans Restructured During the Period  
(Dollar amounts in thousands)

|   | Number<br>of<br>Loans | Pre-<br>Modification<br>Recorded<br>Investment | Funds<br>Disbursed | Interest<br>and Escrow<br>Capitalized | Charge-offs | Post-<br>Modification<br>Recorded<br>Investment |
|---|-----------------------|--|--------------------|---------------------------------------|-------------|---|
| Quarter ended June 30, 2013               |                       |  |                    |                                       |             |   |
| Commercial and industrial                 | 2                     | \$13,354                                       | \$—                | \$—                                   | \$—         | \$13,354  |
| Office, retail, and industrial            | 3                     | 386  | —                  | —                                     | —           | 386   |
| Multi-family                              | 5                     | 1,275  | —                  | 57                                    | —           | 1,332   |
| Other commercial real estate              | 5                     | 564  | —                  | —                                     | —           | 564   |
| Home equity                               | 1                     | 125  | —                  | —                                     | —           | 125   |
| Total TDRs restructured during the period | 16                    | \$15,704                                       | \$—                | \$57                                  | \$—         | \$15,761  |
| Six months ended June 30, 2013            |                       |  |                    |                                       |             |   |
| Commercial and industrial                 | 4                     | \$14,070                                       | \$—                | \$2                                   | \$—         | \$14,072  |
| Office, retail, and industrial            | 4                     | 601  | 30                 | —                                     | —           | 631   |
| Multi-family                              | 5                     | 1,275  | —                  | 57                                    | —           | 1,332   |
| Construction                              | 2                     | 508  | —                  | —                                     | —           | 508   |
| Other commercial real estate              | 5                     | 564  | —                  | —                                     | —           | 564   |
| Home equity                               | 1                     | 125  | —                  | —                                     | —           | 125   |
| 1-4 family mortgages                      | 1                     | 132  | —                  | 4                                     | —           | 136   |
| Total TDRs restructured during the period | 22                    | \$17,275                                       | \$30               | \$63                                  | \$—         | \$17,368  |

Accruing TDRs that do not perform in accordance with their modified terms are transferred to non-accrual. The following table presents TDRs that had payment defaults during the quarters and six months ended June 30, 2014 and 2013 where the default occurred within twelve months of the restructure date.

TDRs That Defaulted Within Twelve Months of the Restructure Date  
(Dollar amounts in thousands)

|                              | Quarters Ended June 30, |                        |                       |                        | Six Months Ended June 30, |                        |                       |                        |
|------------------------------|-------------------------|------------------------|-----------------------|------------------------|---------------------------|------------------------|-----------------------|------------------------|
|                              | 2014                    |                        | 2013                  |                        | 2014                      |                        | 2013                  |                        |
|                              | Number<br>of<br>Loans   | Recorded<br>Investment | Number<br>of<br>Loans | Recorded<br>Investment | Number<br>of<br>Loans     | Recorded<br>Investment | Number<br>of<br>Loans | Recorded<br>Investment |
| Commercial and industrial    | —                       | \$—                    | —                     | \$—                    | 2                         | \$125                  | 1                     | \$350                  |
| Other commercial real estate | —                       | —                      | 1                     | 198                    | —                         | —                      | 3                     | 354                    |
| Total                        | —                       | \$—                    | 1                     | \$198                  | 2                         | \$125                  | 4                     | \$704                  |

A rollforward of the carrying value of TDRs for the quarters and six months ended June 30, 2014 and 2013 is presented in the following table.

## TDR Rollforward

(Dollar amounts in thousands)

|                                | Quarters Ended |          | Six Months Ended |          |
|--------------------------------|----------------|----------|------------------|----------|
|                                | June 30,       |          | June 30,         |          |
|                                | 2014           | 2013     | 2014             | 2013     |
| Accruing                       |                |          |                  |          |
| Beginning balance              | \$6,301        | \$2,587  | \$23,770         | \$6,867  |
| Additions                      | 75             | 2,091    | 75               | 3,526    |
| Net payments received          | (650           | ) (185   | ) (1,110         | ) (214   |
| Returned to performing status  | —              | —        | (18,821          | ) (5,037 |
| Net transfers from non-accrual | (29            | ) 3,794  | 1,783            | 3,145    |
| Ending balance                 | 5,697          | 8,287    | 5,697            | 8,287    |
| Non-accrual                    |                |          |                  |          |
| Beginning balance              | 1,920          | 10,405   | 4,083            | 10,924   |
| Additions                      | —              | 13,670   | —                | 13,842   |
| Net payments received          | (23            | ) (40    | ) (157           | ) (535   |
| Charge-offs                    | (152           | ) (985   | ) (186           | ) (1,788 |
| Transfers to OREO              | (74            | ) —      | (257             | ) (42    |
| Loans sold                     | —              | (806     | ) —              | (806     |
| Net transfers to accruing      | 29             | (3,794   | ) (1,783         | ) (3,145 |
| Ending balance                 | 1,700          | 18,450   | 1,700            | 18,450   |
| Total TDRs                     | \$7,397        | \$26,737 | \$7,397          | \$26,737 |

For TDRs to be removed from TDR status in the calendar year after the restructuring, the loans must (i) have an interest rate and terms that reflect market conditions at the time of restructuring, and (ii) be in compliance with the modified terms. TDRs that were returned to performing status totaled \$18.8 million and \$5.0 million for the six months ended June 30, 2014 and 2013, respectively. Loans that were not restructured at market rates and terms, that are not in compliance with the modified terms, or for which there is a concern about the future ability of the borrower to meet its obligations under the modified terms, continue to be separately reported as restructured until paid in full or charged-off.

There were no material commitments to lend additional funds to borrowers with TDRs as of June 30, 2014 and December 31, 2013.

## 7. EARNINGS PER COMMON SHARE

The table below displays the calculation of basic and diluted earnings per share.

## Basic and Diluted Earnings per Common Share

(Amounts in thousands, except per share data)

|  | Quarters Ended   |          | Six Months Ended |          |
|--|------------------|----------|------------------|----------|
|  | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013     |
| Net income   | \$18,500         | \$16,176 | \$36,164         | \$30,818 |
| Net income applicable to non-vested restricted shares  | (230             | ) (219   | ) (455           | ) (431   |
| Net income applicable to common shares   | \$18,270         | \$15,957 | \$35,709         | \$30,387 |
| Weighted-average common shares outstanding:  |                  |          |                  |          |
| Weighted-average common shares outstanding (basic)   | 74,322           | 74,017   | 74,235           | 73,942   |
| Dilutive effect of common stock equivalents  | 11               | 7        | 12               | 8        |
| Weighted-average diluted common shares outstanding   | 74,333           | 74,024   | 74,247           | 73,950   |
| Basic earnings per common share  | \$0.25           | \$0.22   | \$0.48           | \$0.41   |
| Diluted earnings per common share  | \$0.25           | \$0.22   | \$0.48           | \$0.41   |
| Anti-dilutive shares not included in the computation of diluted earnings per common share <sup>(1)</sup> | 1,177            | 1,447    | 1,246            | 1,520    |

(1) This amount represents outstanding stock options for which the exercise price is greater than the average market price of the Company's common stock.

## 8. INCOME TAXES

The following table presents income tax expense and the effective income tax rate for the quarters ended June 30, 2014 and 2013.

## Income Tax Expense

(Dollar amounts in thousands)

|                                  | Quarters Ended   |          | Six Months Ended |          |
|----------------------------------|------------------|----------|------------------|----------|
|                                  | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013     |
| Income before income tax expense | \$27,142         | \$24,131 | \$52,978         | \$45,066 |
| Income tax expense:              |                  |          |                  |          |
| Federal income tax expense       | \$6,727          | \$5,553  | \$13,005         | \$9,913  |
| State income tax expense         | 1,915            | 2,402    | 3,809            | 4,335    |
| Total income tax expense         | \$8,642          | \$7,955  | \$16,814         | \$14,248 |
| Effective income tax rate        | 31.8             | % 33.0   | % 31.7           | % 31.6   |

Federal income tax expense and the related effective income tax rate are influenced primarily by the amount of tax-exempt income derived from investment securities and BOLI in relation to pre-tax income and state income taxes. State income tax expense and the related effective income tax rate are driven by the amount of state tax-exempt income in relation to pre-tax income and state tax rules related to consolidated/combined reporting and sourcing of income and expense.

The decrease in the effective income tax rate of 31.8% for the second quarter of 2014 compared to 33.0% for the same period in 2013 was due primarily to a decrease in state income tax expense resulting from an increase in income exempt from state taxes and a decrease in statutory rates.

The Company's accounting policies for income taxes are included in Note 1, "Summary of Significant Accounting Policies," and Note 14, "Income Taxes," in the Company's 2013 10-K.

## 9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

In the ordinary course of business, the Company enters into derivative transactions as part of its overall interest rate risk management strategy. The significant accounting policies related to derivative instruments and hedging activities are presented in Note 1, "Summary of Significant Accounting Policies."

### Fair Value Hedges

The Company hedges the fair value of fixed rate commercial real estate loans using interest rate swaps through which the Company pays fixed amounts and receives variable amounts. These derivative contracts are designated as fair value hedges.

### Fair Value Hedges

(Dollar amounts in thousands)

|  | June 30,<br>2014 |   | December 31,<br>2013 |   |
|--|------------------|---|----------------------|---|
| Gross notional amount outstanding  | \$ 14,149        |   | \$ 14,730            |   |
| Derivative liability fair value  | (1,291           | ) | (1,472               | ) |
| Weighted-average interest rate received                                      | 2.06             | % | 2.08                 | % |
| Weighted-average interest rate paid  | 6.38             | % | 6.39                 | % |
| Weighted-average maturity (in years)   | 3.27             |   | 3.76                 |   |
| Fair value of assets needed to settle derivative transactions <sup>(1)</sup> | \$ 1,319         |   | \$ 1,502             |   |

(1) This amount represents the fair value if credit risk related contingent features were triggered.

Hedge ineffectiveness is recognized in other noninterest income in the Condensed Consolidated Statements of Income. For the quarters and six months ended June 30, 2014 and 2013, fair value hedge ineffectiveness was not material.

### Cash Flow Hedges

During the second quarter of 2014, the Company hedged \$125.0 million of certain corporate variable rate loans using interest rate swaps through which the Company receives fixed amounts and pays variable amounts. The Company also hedged \$125.0 million of borrowed funds using two forward starting interest rate swaps through which the Company receives variable amounts and pays fixed amounts. The two forward starting interest rate swaps begin on June 1, 2015 and June 1, 2016 and mature on June 1, 2019. These derivative contracts are designated as cash flow hedges.

### Cash Flow Hedges

(Dollar amounts in thousands)

|   | June 30,<br>2014 |   | December 31,<br>2013 |  |
|---|------------------|---|----------------------|--|
| Gross notional amount outstanding       | \$ 250,000       |   | \$ —                 |  |
| Derivative asset fair value             | 4                |   | —                    |  |
| Derivative liability fair value         | (202             | ) | —                    |  |
| Weighted-average interest rate received | 1.55             | % | —                    |  |
| Weighted-average interest rate paid     | 0.15             | % | —                    |  |
| Weighted-average maturity (in years)    | 4.90             |   | —                    |  |

The effective portion of gains or losses on cash flow hedges is recorded in accumulated other comprehensive income on an after-tax basis and is subsequently reclassified to interest income or expense in the period that the forecasted hedge impacts earnings. Hedge ineffectiveness is determined using a regression analysis at the inception of the hedge

relationship and on an ongoing basis. For the quarter ended June 30, 2014, there were no gains or losses related to cash flow hedge ineffectiveness. As of June 30, 2014, the Company estimates that \$1.8 million will be reclassified from accumulated other comprehensive income as an increase to interest income over the next twelve months.

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## Other Derivative Instruments

The Company also enters into derivative transactions with its commercial customers and simultaneously enters into an offsetting interest rate derivative transaction with a third party. This transaction allows the Company's customers to effectively convert a variable rate loan into a fixed rate loan. Due to the offsetting nature of these transactions, the Company does not apply hedge accounting treatment. Transaction fees related to commercial customer derivative instruments of \$258,000 and \$462,000 were recorded in noninterest income for the quarter and six months ended June 30, 2014, respectively. There were no transaction fees recorded for the second quarter of 2013 and \$522,000 was recorded for the six months ended June 30, 2013.

Other Derivative Instruments  
(Dollar amounts in thousands)

|  | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
| Gross notional amount outstanding  | \$350,669        | \$256,638            |
| Derivative asset fair value  | 5,019            | 2,235                |
| Derivative liability fair value  | (5,019           | ) (2,235             |
| Fair value of assets needed to settle derivative transactions <sup>(1)</sup> | 5,089            | 1,305                |

(1) This amount represents the fair value if credit risk related contingent features were triggered.

The Company's derivative portfolio also includes other derivative instruments that do not receive hedge accounting treatment, such as commitments to originate 1-4 family mortgage loans and foreign exchange contracts. In addition, the Company occasionally enters into risk participation agreements with counterparty banks to transfer or assume a portion of the credit risk related to customer transactions. The amounts of these instruments were not material for any periods presented. The Company had no other derivative instruments as of June 30, 2014 or December 31, 2013. The Company does not enter into derivative transactions for purely speculative purposes.

## Credit Risk

Derivative instruments are inherently subject to credit risk, which represents the Company's risk of loss when the counterparty to a derivative contract fails to perform according to the terms of the agreement. Credit risk is managed by limiting and collateralizing the aggregate amount of net unrealized losses by transaction, monitoring the size and the maturity structure of the derivatives, and applying uniform credit standards. Company policy establishes limits on credit exposure to any single counterparty. In addition, the Company established bilateral collateral agreements with derivative counterparties that provide for exchanges of marketable securities or cash to collateralize either party's net losses above a stated minimum threshold.



Certain derivative instruments are subject to master netting agreements with counterparties. The Company records these transactions at their gross fair values and does not offset derivative assets and liabilities on the Consolidated Statements of Condition. The following table presents the Company's derivatives and offsetting positions as of June 30, 2014 and December 31, 2013.

## Offsetting Derivatives

(Dollar amounts in thousands)

|   | Derivative Assets |                      | Derivative Liabilities |                      |
|---|-------------------|----------------------|------------------------|----------------------|
|   | Fair Value        |                      | Fair Value             |                      |
|   | June 30,<br>2014  | December 31,<br>2013 | June 30,<br>2014       | December 31,<br>2013 |
| Gross amounts recognized  | \$5,023           | \$2,235              | \$6,512                | \$3,707              |
| Less: Amounts offset in the Consolidated Statements of Financial Condition                | —                 | —                    | —                      | —                    |
| Net amount presented in the Consolidated Statements of Financial Condition <sup>(1)</sup> | 5,023             | 2,235                | 6,512                  | 3,707                |
| Gross amounts not offset in the Consolidated Statements of Financial Condition            |                   |                      |                        |                      |
| Offsetting derivative positions   | (79               | ) (704               | ) (79                  | ) (704               |
| Cash collateral pledged   | —                 | —                    | (6,433                 | ) (3,003             |
| Net credit exposure   | \$4,944           | \$1,531              | \$—                    | \$—                  |

<sup>(1)</sup> Included in other assets or other liabilities in the Consolidated Statements of Financial Condition.

As of June 30, 2014 and December 31, 2013, the Company's derivative instruments generally contained provisions that require the Company's debt to remain above a certain credit rating by each of the major credit rating agencies or that the Company maintain certain capital levels. If the Company's debt were to fall below that credit rating or the Company's capital were to fall below the required levels, it would be in violation of those provisions, and the counterparties to the derivative instruments could terminate the swap transaction and demand cash settlement of the derivative instrument in an amount equal to the derivative liability fair value. As of June 30, 2014 and December 31, 2013, the Company was not in violation of these provisions.

## 10. COMMITMENTS, GUARANTEES, AND CONTINGENT LIABILITIES

## Credit Commitments and Guarantees

In the normal course of business, the Company enters into a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers and to conduct lending activities, including commitments to extend credit and standby and commercial letters of credit. These instruments involve elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Statements of Financial Condition.

## Contractual or Notional Amounts of Financial Instruments

(Dollar amounts in thousands)

|  | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
| Commitments to extend credit:                        |                  |                      |
| Commercial, industrial, and agricultural             | \$1,140,571      | \$1,077,201          |
| Commercial real estate                               | 125,437          | 133,867              |
| Home equity  | 283,761          | 268,311              |
| Other commitments <sup>(1)</sup>                     | 179,969          | 181,702              |
| Total commitments to extend credit                   | \$1,729,738      | \$1,661,081          |
| Standby letters of credit                            | \$110,715        | \$110,453            |
| Recourse on assets sold:                             |                  |                      |
| Unpaid principal balance of loans sold               | \$179,981        | \$170,330            |
| Carrying value of recourse obligation <sup>(2)</sup> | 163              | 162                  |

<sup>(1)</sup> Other commitments includes installment and overdraft protection program commitments.

<sup>(2)</sup> Included in other liabilities in the Consolidated Statements of Financial Condition.

Commitments to extend credit are agreements to lend funds to a customer, subject to contractual terms and covenants. Commitments generally have fixed expiration dates or other termination clauses, variable interest rates, and fee requirements, when applicable. Since many of the commitments are expected to expire without being drawn, the total commitment amounts do not necessarily represent future cash flow requirements.

In the event of a customer's non-performance, the Company's credit loss exposure is equal to the contractual amount of the commitments. The credit risk is essentially the same as extending loans to customers. The Company uses the same credit policies for credit commitments as its loans and minimizes exposure to credit loss through various collateral requirements.

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent on the failure of the customer to perform according to the terms of the contract with the third party and are often issued in favor of a municipality where construction is taking place to ensure the borrower adequately completes the construction.

The maximum potential future payments guaranteed by the Company under standby letters of credit arrangements are equal to the contractual amount of the commitment. If a commitment is funded, the Company may seek recourse through the liquidation of the underlying collateral, including real estate, production plants and property, marketable securities, or receipt of cash.

As a result of the sale of certain 1-4 family mortgage loans, the Company is contractually obligated to repurchase any non-performing loans or loans that do not meet underwriting requirements at recorded value. In accordance with the sales agreements, there is no limitation to the maximum potential future payments or expiration of the Company's recourse obligation. There were no material loan repurchases during the quarters ended June 30, 2014 and 2013.

## Legal Proceedings

In the ordinary course of business, there were certain legal proceedings pending against the Company and its subsidiaries at June 30, 2014. While the outcome of any legal proceeding is inherently uncertain, based on information currently available, the Company's management believes that any liabilities arising from pending legal matters are not expected to have a material adverse effect on the Company's financial position, results of operations, or cash flows.

## 11. FAIR VALUE

Fair value represents the amount expected to be received to sell an asset or paid to transfer a liability in its principal or most advantageous market in an orderly transaction between market participants at the measurement date. In accordance with fair value accounting guidance, the Company measures, records, and reports various types of assets and liabilities at fair value on either a recurring or non-recurring basis in the Consolidated Statements of Financial Condition. Those assets and liabilities are presented below in the sections titled "Assets and Liabilities Required to be Measured at Fair Value on a Recurring Basis" and "Assets and Liabilities Required to be Measured at Fair Value on a Non-Recurring Basis."

Other assets and liabilities are not required to be measured at fair value in the Consolidated Statements of Financial Condition, but must be disclosed at fair value. Refer to the "Fair Value Measurements of Other Financial Instruments" section of this footnote. Any aggregation of the estimated fair values presented in this footnote does not represent the value of the Company.

Depending on the nature of the asset or liability, the Company uses various valuation methodologies and assumptions to estimate fair value. GAAP provides a three-tiered fair value hierarchy based on the inputs used to measure fair value. The hierarchy is defined as follows:

• Level 1 - Quoted prices in active markets for identical assets or liabilities.

• Level 2 - Observable inputs other than level 1 prices, such as quoted prices for similar instruments, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

• Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These inputs require significant management judgment or estimation, some of which use model-based techniques and may be internally developed.

Assets and liabilities are assigned to a level within the fair value hierarchy based on the lowest level of significant input used to measure fair value. Assets and liabilities may change levels within the fair value hierarchy due to market conditions or other circumstances. Those transfers are recognized on the date of the event that prompted the transfer. There were no transfers of assets or liabilities between levels of the fair value hierarchy during the periods presented.

## Assets and Liabilities Required to be Measured at Fair Value on a Recurring Basis

The following table provides the fair value for assets and liabilities required to be measured at fair value on a recurring basis in the Consolidated Statements of Financial Condition by level in the fair value hierarchy.

## Recurring Fair Value Measurements

(Dollar amounts in thousands)

|  | June 30, 2014 |           |         | December 31, 2013 |           |         |
|--|---------------|-----------|---------|-------------------|-----------|---------|
|  | Level 1       | Level 2   | Level 3 | Level 1           | Level 2   | Level 3 |
| Assets:                                  |               |           |         |                   |           |         |
| Trading securities:                      |               |           |         |                   |           |         |
| Money market funds                       | \$1,369       | \$—       | \$—     | \$1,847           | \$—       | \$—     |
| Mutual funds                             | 16,862        | —         | —       | 15,470            | —         | —       |
| Total trading securities                 | 18,231        | —         | —       | 17,317            | —         | —       |
| Securities available-for-sale:           |               |           |         |                   |           |         |
| U.S. Agency securities                   | —             | 501       | —       | —                 | 500       | —       |
| CMOs                                     | —             | 441,465   | —       | —                 | 475,768   | —       |
| Other MBSs                               | —             | 127,492   | —       | —                 | 136,164   | —       |
| Municipal securities                     | —             | 443,885   | —       | —                 | 461,393   | —       |
| CDOs                                     | —             | —         | 18,436  | —                 | —         | 18,309  |
| Corporate debt securities                | —             | 15,235    | —       | —                 | 14,929    | —       |
| Hedge fund investment                    | —             | 816       | —       | —                 | 3,179     | —       |
| Other equity securities                  | 44            | 2,601     | —       | 44                | 2,439     | —       |
| Total securities available-for-sale      | 44            | 1,031,995 | 18,436  | 44                | 1,094,372 | 18,309  |
| Mortgage servicing rights <sup>(1)</sup> | —             | —         | 1,885   | —                 | —         | 1,893   |
| Derivative assets <sup>(1)</sup>         | —             | 5,023     | —       | —                 | 2,235     | —       |
| Liabilities:                             |               |           |         |                   |           |         |
| Derivative liabilities <sup>(2)</sup>    | \$—           | \$6,512   | \$—     | \$—               | \$3,707   | \$—     |

<sup>(1)</sup> Included in other assets in the Consolidated Statements of Financial Condition.

<sup>(2)</sup> Included in other liabilities in the Consolidated Statements of Financial Condition.

The following sections describe the specific valuation techniques and inputs used to measure financial assets and liabilities at fair value.

## Trading Securities

The Company's trading securities consist of diversified investment securities held in a grantor trust and are invested in money market and mutual funds. The fair value of these money market and mutual funds is based on quoted market prices in active exchange markets and is classified in level 1 of the fair value hierarchy.

## Securities Available-for-Sale

The Company's available-for-sale securities are primarily fixed income instruments that are not quoted on an exchange, but may be traded in active markets. The fair values are based on quoted prices in active markets or market prices for similar securities obtained from external pricing services or dealer market participants and are classified in level 2 of the fair value hierarchy. Quarterly, the Company evaluates the methodologies used by its external pricing services to develop the fair values to determine whether the results of the valuations are representative of an exit price in the Company's principal markets and an appropriate representation of fair value.

The Company's hedge fund investment is classified in level 2 of the fair value hierarchy. The fair value is derived from monthly and annual financial statements provided by hedge fund management. The majority of the hedge fund's investment portfolio is held in securities that are freely tradable and are listed on national securities exchanges.

CDOs are classified in level 3 of the fair value hierarchy. The Company estimates the fair values for each CDO using discounted cash flow analyses with the assistance of a structured credit valuation firm. This methodology relies on credit analysis and review of historical financial data for each of the issuers of the securities underlying the individual CDO (the "Issuers") to estimate the cash flows. These estimates are highly subjective and sensitive to several significant, unobservable inputs, including prepayment assumptions, default probabilities, loss given default assumptions, and deferral cure probabilities. The cash flows for each Issuer are then discounted to present values using LIBOR plus an adjustment to reflect the higher risk inherent in these securities given their complex structures and the impact of market factors. Finally, the discounted cash flows for each Issuer are aggregated to derive the estimated fair value for the specific CDO. Information for each CDO, as well as the significant unobservable assumptions, is presented in the following table.

Characteristics of CDOs and Significant Unobservable Inputs  
Used in the Valuation of CDOs as of June 30, 2014  
(Dollar amounts in thousands)

|   | CDO Number |          |          |          |         |   |
|---|------------|----------|----------|----------|---------|---|
|   | 1          | 2        | 3        | 4        | 5       |   |
| Characteristics:  |            |          |          |          |         |   |
| Class   | C-1        | C-1      | C-1      | B1       | C       |   |
| Original par  | \$17,500   | \$15,000 | \$15,000 | \$15,000 | \$6,500 |   |
| Amortized cost  | 7,140      | 5,598    | 12,377   | 13,729   | 6,179   |   |
| Fair value  | 4,849      | 662      | 4,641    | 5,838    | 2,446   |   |
| Lowest credit rating (Moody's)                                | Ca         | Ca       | Ca       | Ca       | Ca      |   |
| Number of underlying Issuers                                  | 43         | 54       | 57       | 58       | 75      |   |
| Percent of Issuers currently performing                       | 83.7       | % 79.6   | % 75.4   | % 55.2   | % 73.3  | % |
| Current deferral and default percent <sup>(1)</sup>           | 8.7        | % 11.4   | % 11.8   | % 29.8   | % 22.5  | % |
| Expected future deferral and default percent <sup>(2)</sup>   | 12.3       | % 12.0   | % 15.2   | % 22.3   | % 9.8   | % |
| Excess subordination percent <sup>(3)</sup>                   | —          | % —      | % —      | % 1.5    | % 11.4  | % |
| Discount rate risk adjustment <sup>(4)</sup>                  | 12.5       | % 14.3   | % 13.3   | % 11.8   | % 12.3  | % |
| Significant unobservable inputs, weighted average of Issuers: |            |          |          |          |         |   |
| Probability of prepayment                                     | 15.2       | % 7.6    | % 4.4    | % 6.1    | % 3.5   | % |
| Probability of default  | 18.5       | % 23.1   | % 21.2   | % 28.3   | % 28.8  | % |
| Loss given default  | 88.2       | % 83.4   | % 89.4   | % 92.9   | % 96.2  | % |
| Probability of deferral cure                                  | 23.2       | % 17.7   | % 31.3   | % 41.1   | % 27.6  | % |

<sup>(1)</sup> Represents actual deferrals and defaults, net of recoveries, as a percent of the original collateral.

Represents expected future deferrals and defaults, net of recoveries, as a percent of the remaining performing collateral. The probability of future defaults is derived for each Issuer based on a credit analysis. The associated

<sup>(2)</sup> assumed loss given default is based on historical default and recovery information provided by a nationally recognized credit rating agency and is assumed to be 90% for banks, 85% for insurance companies, and 100% for Issuers that have already defaulted.

<sup>(3)</sup> Represents additional defaults that the CDO can absorb before the security experiences any credit impairment. The excess subordination percentage is calculated by dividing the amount of potential additional loss that can be absorbed (before the receipt of all expected future principal and interest payments is affected) by the total balance of performing collateral.

<sup>(4)</sup> Cash flows are discounted at LIBOR plus this adjustment to reflect the higher risk inherent in these securities.

Most Issuers have the right to prepay the securities on the fifth anniversary of issuance and under other limited circumstances. To estimate prepayments, a credit analysis of each Issuer is performed to estimate its ability and

likelihood to fund a prepayment. If a prepayment occurs, the Company receives cash equal to the par value for the portion of the CDO associated with that Issuer.

The likelihood that an Issuer who is currently deferring payment on the securities will pay all deferred amounts and remain current thereafter is based on an analysis of the Issuer's asset quality, leverage ratios, and other measures of financial viability.

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The impact of changes in these key inputs could result in a significantly higher or lower fair value measurement for each CDO. The timing of the default, the magnitude of the default, and the timing and magnitude of the cure probability are directly interrelated. Defaults that occur sooner and/or are greater than anticipated have a negative impact on the valuation. In addition, a high cure probability assumption has a positive effect on the fair value, and, if a cure event takes place sooner than anticipated, the impact on the valuation is also favorable.

Management monitors the valuation results of each CDO on a quarterly basis, which includes an analysis of historical pricing trends for these types of securities, overall economic conditions (such as tracking LIBOR curves), and the performance of the Issuers' industries. Management also reviews market activity for the same or similar tranches of the CDOs, when available. Annually, management validates significant assumptions by reviewing detailed back-testing performed by the structured credit valuation firm.

A rollforward of the carrying value of CDOs for the quarters and six months ended June 30, 2014 and 2013 is presented in the following table.

Rollforward of the Carrying Value of CDOs  
(Dollar amounts in thousands)

|  | Quarters Ended |          | Six Months Ended |          |
|--|----------------|----------|------------------|----------|
|  | June 30,       |          | June 30,         |          |
|  | 2014           | 2013     | 2014             | 2013     |
| Beginning balance  | \$21,666       | \$12,924 | \$18,309         | \$12,129 |
| Change in other comprehensive income (loss) <sup>(1)</sup>   | (1,721         | ) 1,993  | 1,636            | 2,788    |
| Purchases, sales, issuances, settlements, and paydowns <sup>(2)</sup>                                | (1,509         | ) —      | (1,509           | ) —      |
| Ending balance   | \$18,436       | \$14,917 | \$18,436         | \$14,917 |
| Change in unrealized losses recognized in earnings related to securities still held at end of period | \$—            | \$—      | \$—              | \$—      |

<sup>(1)</sup> Included in unrealized holding gains (losses) in the Consolidated Statements of Comprehensive Income.

<sup>(2)</sup> During the second quarter of 2014, one CDO with a carrying value of \$1.3 million was sold. In addition, one CDO with a carrying value of zero was sold during the second quarter of 2013.

### Mortgage Servicing Rights

The Company services loans for others totaling \$219.3 million as of June 30, 2014 and \$214.5 million as of December 31, 2013. These loans are owned by third parties and are not included in the Consolidated Statements of Condition. The Company estimates the fair value of mortgage servicing rights by using a discounted cash flow analysis and classifies them in level 3 of the fair value hierarchy. Additional information regarding the Company's mortgage servicing rights can be found in Note 21, "Fair Value," in the Company's 2013 10-K.

### Derivative Assets and Derivative Liabilities

The Company enters into interest rate swaps and derivative transactions with commercial customers. These derivative transactions are executed in the dealer market, and pricing is based on market quotes obtained from the counterparties. The market quotes were developed using market observable inputs, which primarily include LIBOR. Therefore, derivatives are classified in level 2 of the fair value hierarchy. For its derivative assets and liabilities, the Company also considers non-performance risk, including the likelihood of default by itself and its counterparties, when evaluating whether the market quotes from the counterparty are representative of an exit price.



## Assets and Liabilities Required to be Measured at Fair Value on a Non-Recurring Basis

The following table provides the fair value for each class of assets and liabilities required to be measured at fair value on a non-recurring basis in the Consolidated Statements of Financial Condition by level in the fair value hierarchy.

## Non-Recurring Fair Value Measurements

(Dollar amounts in thousands)

|  | June 30, 2014 |         |          | December 31, 2013 |         |          |
|--|---------------|---------|----------|-------------------|---------|----------|
|  | Level 1       | Level 2 | Level 3  | Level 1           | Level 2 | Level 3  |
| Collateral-dependent impaired loans <sup>(1)</sup> | \$—           | \$—     | \$23,111 | \$—               | \$—     | \$13,103 |
| OREO <sup>(2)</sup>                                | —             | —       | 16,266   | —                 | —       | 13,347   |
| Loans held-for-sale <sup>(3)</sup>                 | —             | —       | 21,125   | —                 | —       | 4,739    |
| Assets held-for-sale <sup>(4)</sup>                | —             | —       | 4,318    | —                 | —       | 4,027    |

<sup>(1)</sup> Includes impaired loans with charge-offs and impaired loans with a specific reserve during the periods presented.

<sup>(2)</sup> Includes OREO and covered OREO with fair value adjustments subsequent to initial transfer that occurred during the periods presented.

<sup>(3)</sup> Included in other assets in the Consolidated Statements of Financial Condition.

<sup>(4)</sup> Included in premises, furniture, and equipment in the Consolidated Statements of Financial Condition.

## Collateral-Dependent Impaired Loans

Certain collateral-dependent impaired loans are subject to fair value adjustments to reflect the difference between the carrying value of the loan and the value of the underlying collateral. The fair values of collateral-dependent impaired loans are primarily determined by current appraised values of the underlying collateral. Based on the age and/or type, appraisals may be adjusted in the range of 0% to 20%. In certain cases, an internal valuation may be used when the underlying collateral is located in areas where comparable sales data is limited or unavailable. Accordingly, collateral-dependent impaired loans are classified in level 3 of the fair value hierarchy.

Collateral-dependent impaired loans for which the fair value is greater than the recorded investment are not measured at fair value in the Consolidated Statements of Financial Condition and are not included in this disclosure.

## OREO

The fair value of OREO is measured using the current appraised value of the properties. In certain circumstances, a current appraisal may not be available or may not represent an accurate measurement of the property's fair value due to outdated market information or other factors. In these cases, the fair value is determined based on the lower of the (i) most recent appraised value, (ii) broker price opinion, (iii) current listing price, or (iv) signed sales contract. Given these valuation methods, OREO is classified in level 3 of the fair value hierarchy.

## Loans Held-for-Sale

As of June 30, 2014, loans held-for-sale consisted of 1-4 family mortgage loans, which were originated with the intent to sell, and one commercial real estate credit relationship, which was transferred to the held-for-sale category at the contract price. Accordingly, these loans are classified in level 3 of the fair value hierarchy. As of December 31, 2013, loans held-for-sale consists of 1-4 family mortgage loans and one commercial real estate loan.

## Assets Held-for-Sale

Assets held-for-sale consist of former branches that are no longer in operation, which were transferred into the held-for-sale category at the lower of their fair value as determined by a current appraisal or their recorded investment. Based on these valuation methods, they are classified in level 3 of the fair value hierarchy.



## Financial Instruments Not Required to be Measured at Fair Value

For certain financial instruments that are not required to be measured at fair value in the Consolidated Statements of Financial Condition, the Company must disclose the estimated fair values and the level within the fair value hierarchy as shown in the following table.

Fair Value Measurements of Other Financial Instruments  
(Dollar amounts in thousands)

|  | Fair Value Hierarchy Level | June 30, 2014   |             | December 31, 2013 |             |
|--|----------------------------|-----------------|-------------|-------------------|-------------|
|  |                            | Carrying Amount | Fair Value  | Carrying Amount   | Fair Value  |
| <b>Assets:</b>                           |                            |                 |             |                   |             |
| Cash and due from banks                  | 1                          | \$155,099       | \$155,099   | \$110,417         | \$110,417   |
| Interest-bearing deposits in other banks | 2                          | 322,874         | 322,874     | 476,824           | 476,824     |
| Securities held-to-maturity              | 2                          | 26,471          | 27,076      | 44,322            | 43,387      |
| FHLB and Federal Reserve Bank stock      | 2                          | 35,588          | 35,588      | 35,161            | 35,161      |
| Net loans                                | 3                          | 5,869,998       | 5,775,061   | 5,628,855         | 5,544,146   |
| FDIC indemnification asset               | 3                          | 10,276          | 2,464       | 16,585            | 7,829       |
| Investment in BOLI                       | 3                          | 194,502         | 194,502     | 193,167           | 193,167     |
| Accrued interest receivable              | 3                          | 23,633          | 23,633      | 25,735            | 25,735      |
| Other interest earning assets            | 3                          | 5,117           | 5,297       | 6,550             | 6,809       |
| <b>Liabilities:</b>                      |                            |                 |             |                   |             |
| Deposits                                 | 2                          | \$6,895,250     | \$6,892,876 | \$6,766,101       | \$6,765,404 |
| Borrowed funds                           | 2                          | 104,201         | 104,201     | 224,342           | 226,839     |
| Senior and subordinated debt             | 1                          | 190,996         | 193,628     | 190,932           | 201,147     |
| Accrued interest payable                 | 2                          | 2,164           | 2,164       | 2,400             | 2,400       |

Management uses various methodologies and assumptions to determine the estimated fair values of the financial instruments in the table above. The fair value estimates are made at a discrete point in time based on relevant market information and consider management's judgments regarding future expected economic conditions, loss experience, and specific risk characteristics of the financial instruments.

**Short-Term Financial Assets and Liabilities** - For financial instruments with a shorter-term or with no stated maturity, prevailing market rates, and limited credit risk, the carrying amounts approximate fair value. Those financial instruments include cash and due from banks, interest-bearing deposits in other banks, other short-term investments, accrued interest receivable, and accrued interest payable.

**Securities Held-to-Maturity** - The fair value of securities held-to-maturity is estimated using the present value of future cash flows of the remaining maturities of the securities.

**FHLB and Federal Reserve Bank Stock** - The carrying amounts approximate fair value.

**Net Loans** - The fair value of loans is estimated using the present value of the future cash flows of the remaining maturities of the loans. Prepayment assumptions that consider the Company's historical experience and current economic and lending conditions were included. The discount rate was based on the LIBOR yield curve with adjustments for liquidity and credit risk. The primary impact of credit risk on the fair value of the loan portfolio was accommodated through the use of the allowance for loan and covered loan losses, which is believed to represent the current fair value of estimated inherent losses in the loan portfolio.

FDIC Indemnification Asset - The fair value of the FDIC indemnification asset is calculated by discounting the cash flows expected to be received from the FDIC. The future cash flows are estimated by multiplying expected losses on covered loans and covered OREO by the reimbursement rates in the FDIC Agreements.

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Investment in BOLI - The fair value of the investment in BOLI approximates the carrying amount as both are based on each policy's respective cash surrender value ("CSV"), which is the amount the Company would receive from liquidation of these investments. The CSV is derived from monthly reports provided by the managing brokers and is determined using the Company's initial insurance premium and earnings of the underlying assets, offset by management fees.

Other Interest-Earning Assets - The fair value of other interest-earning assets is estimated using the present value of the future cash flows of the remaining maturities of the assets.

Deposits - The fair values disclosed for deposits, savings deposits, NOW accounts, and money market deposits are equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair value for fixed-rate time deposits was estimated using the future cash flows discounted based on the LIBOR yield curve, plus or minus the spread associated with current pricing.

Borrowed Funds - The fair value of FHLB advances is estimated by discounting the agreements based on maturities using the rates currently offered for FHLB advances of similar remaining maturities adjusted for prepayment penalties that would be incurred if the borrowings were paid off on the measurement date. The carrying amounts of securities sold under agreements to repurchase approximate their fair value due to their short-term nature.

Senior and Subordinated Debt - The fair value of senior and subordinated debt is determined using quoted market prices.

The Company estimated the fair value of lending commitments outstanding to be immaterial based on the following factors: (i) the limited interest rate exposure of the commitments outstanding due to their variable nature, (ii) the short-term nature of the commitment periods, (iii) termination clauses provided in the agreements, and (iv) the market rate of fees charged.

## 12. SUBSEQUENT EVENTS

On July 7, 2014, the Company entered into a definitive agreement to acquire the south suburban Chicago-based Great Lakes Financial Resources, Inc., the holding company for Great Lakes Bank, National Association. As part of the acquisition, the Company will acquire eight locations, approximately \$490 million in deposits, and \$234 million in loans. The merger consideration will be a combination of Company stock and cash, with an overall transaction value of approximately \$58.0 million, subject to certain adjustments based on the stock price of the Company prior to closing. The acquisition is subject to approval by the stockholders of Great Lakes Financial Resources, Inc., customary regulatory approvals, and certain closing conditions, and is expected to close before the end of 2014.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### INTRODUCTION

First Midwest Bancorp, Inc. (the "Company") is a bank holding company headquartered in the Chicago suburb of Itasca, Illinois with operations throughout the greater Chicago metropolitan area as well as northwest Indiana, central and western Illinois, and eastern Iowa. Our principal subsidiary is First Midwest Bank (the "Bank"), which provides a broad range of commercial and retail banking and wealth management services to consumer, commercial and industrial, commercial real estate, and municipal customers through approximately 90 banking offices. We are committed to meeting the financial needs of the people and businesses in the communities where we live and work by providing customized banking solutions, quality products, and innovative services that fulfill those financial needs.

The following discussion and analysis is intended to address the significant factors affecting our results of operations and financial condition for the quarters and six months ended June 30, 2014 and 2013. When we use the terms "First Midwest," the "Company," "we," "us," and "our," we mean First Midwest Bancorp, Inc., a Delaware Corporation, and its consolidated subsidiaries. When we use the term "Bank," we are referring to our wholly owned banking subsidiary, First Midwest Bank. Management's discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes presented elsewhere in this report, as well as in our 2013 Annual Report on Form 10-K ("2013 10-K"). The results of operations for the quarter and six months ended June 30, 2014 are not necessarily indicative of future results.

Our results of operations are affected by various factors, many of which are beyond our control, including interest rates, local and national economic conditions, business spending, consumer confidence, certain seasonal factors, legislative and regulatory changes, and changes in real estate and securities markets. Our management evaluates performance using a variety of qualitative and quantitative metrics. The primary quantitative metrics used by management include:

• **Net Interest Income** - Net interest income, our primary source of revenue, equals the difference between interest income and fees earned on interest-earning assets and interest expense incurred on interest-bearing liabilities.

• **Net Interest Margin** - Net interest margin equals net interest income divided by total average interest-earning assets.

• **Noninterest Income** - Noninterest income is the income we earn from fee-based revenues, investment in bank-owned life insurance ("BOLI") and other income, and non-operating revenues.

• **Asset Quality** - Asset quality represents an estimation of the quality of our loan portfolio, including an assessment of the credit risk related to existing and potential loss exposure, and can be evaluated using a number of quantitative measures, such as non-performing loans to total loans.

• **Regulatory Capital** - Our regulatory capital is currently classified in one of the following two tiers: (i) Tier 1 capital consists of common equity, retained earnings, and qualifying trust-preferred securities, less goodwill and most intangible assets and (ii) Tier 2 capital includes qualifying subordinated debt and the allowance for credit losses, subject to limitations.

Unless otherwise stated, all earnings per common share data included in this section and throughout the remainder of this discussion are presented on a diluted basis.

### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q may contain certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. In some cases, forward-looking statements can be identified by the use of words such as "may," "might," "will," "would," "should," "could," "expect," "plan," "intend," "anticipate," "believe," "probable," "potential," "possible," or "continue" and words of similar import. Forward-looking statements are not historical



facts but instead express only management's beliefs regarding future results or events, many of which, by their nature, are inherently uncertain and outside of management's control. It is possible that actual results and events may differ, possibly materially, from the anticipated results or events indicated in these forward-looking statements.

Forward-looking statements are not guarantees of future performance, and we caution you not to place undue reliance on these statements. Forward-looking statements are made only as of the date of this report, and we undertake no obligation to update any forward-looking statements contained in this report to reflect new information or events or conditions after the date hereof.

Forward-looking statements may be deemed to include, among other things, statements relating to our future financial performance, the performance of our loan or securities portfolio, the expected amount of future credit reserves or charge-offs, corporate strategies or objectives, anticipated trends in our business, regulatory developments, pending acquisition transactions, and growth strategies, including possible future acquisitions. These statements are subject to certain risks, uncertainties and assumptions. For a discussion of these risks, uncertainties and assumptions, you should refer to the sections entitled "Risk Factors" and "Management's Discussion

and Analysis of Financial Condition and Results of Operations” in this report and in our 2013 10-K, as well as our subsequent filings made with the Securities and Exchange Commission (“SEC”). However, these risks and uncertainties are not exhaustive. Other sections of this report describe additional factors that could adversely impact our business and financial performance.

### CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”) and are consistent with predominant practices in the financial services industry. Critical accounting policies are those policies that management believes are the most important to our financial position and results of operations. Application of critical accounting policies requires management to make estimates, assumptions, and judgments based on information available as of the date of the financial statements that affect the amounts reported in the financial statements and accompanying notes. Future changes in information may affect these estimates, assumptions, and judgments, which may affect the amounts reported in the financial statements.

For additional information regarding critical accounting policies, refer to “Summary of Significant Accounting Policies,” presented in Note 1 to the Condensed Consolidated Financial Statements and the section titled “Critical Accounting Policies” in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the Company’s 2013 10-K. There have been no significant changes in the Company’s application of critical accounting policies related to the allowance for credit losses, valuation of securities, and income taxes since December 31, 2013.

### PERFORMANCE OVERVIEW

Table 1

#### Selected Financial Data

(Dollar and share amounts in thousands, except per share data)

|  | Quarters Ended   |          | Six Months Ended |           |   |
|--|------------------|----------|------------------|-----------|---|
|  | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013      |   |
| <b>Operating Results</b>                           |                  |          |                  |           |   |
| Interest income                                    | \$72,003         | \$71,753 | \$141,693        | \$142,798 |   |
| Interest expense                                   | 5,696            | 6,823    | 11,691           | 14,020    |   |
| Net interest income                                | 66,307           | 64,930   | 130,002          | 128,778   |   |
| Provision for loan and covered loan losses         | 5,341            | 5,813    | 6,782            | 11,487    |   |
| Noninterest income                                 | 31,193           | 27,441   | 58,443           | 55,016    |   |
| Noninterest expense                                | 65,017           | 62,427   | 128,685          | 127,241   |   |
| Income before income tax expense                   | 27,142           | 24,131   | 52,978           | 45,066    |   |
| Income tax expense                                 | 8,642            | 7,955    | 16,814           | 14,248    |   |
| Net income   | \$18,500         | \$16,176 | \$36,164         | \$30,818  |   |
| Weighted-average diluted common shares outstanding | 74,333           | 74,024   | 74,247           | 73,950    |   |
| Diluted earnings per common share                  | \$0.25           | \$0.22   | \$0.48           | \$0.41    |   |
| <b>Performance Ratios <sup>(1)</sup></b>           |                  |          |                  |           |   |
| Return on average common equity                    | 7.08             | % 6.66   | % 7.03           | % 6.42    | % |
| Return on average assets                           | 0.88             | % 0.79   | % 0.87           | % 0.76    | % |
| Net interest margin – tax equivalent               | 3.65             | % 3.70   | % 3.63           | % 3.73    | % |
| Efficiency ratio <sup>(2)</sup>                    | 63.60            | % 64.27  | % 65.09          | % 65.38   | % |

(1) All ratios are presented on an annualized basis.

(2) The efficiency ratio expresses noninterest expense, excluding other real estate owned (“OREO”) expense, as a percentage of tax-equivalent net interest income plus total fee-based revenues, other income, net trading gains, and tax-equivalent adjusted BOLI income. Net securities gains are excluded from the efficiency ratio. The \$2.1 million

loss on the prepayment of Federal Home Loan Bank ("FHLB") advances and \$830,000 of acquisition-related expenses are excluded from the efficiency ratio for the quarter and six months ended June 30, 2014.

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|  | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 | June 30, 2014<br>Change From<br>December 31,<br>2013 | June 30,<br>2013 |
|--|------------------|----------------------|------------------|--|------------------|
| <b>Balance Sheet Highlights</b>          |                  |                      |                  |  |                  |
| Total assets                             | \$8,305,247      | \$8,253,407          | \$8,343,325      | \$51,840   | \$(38,078 )      |
| Total loans, excluding covered loans     | 5,843,457        | 5,580,005            | 5,287,565        | 263,452  | 555,892          |
| Total loans, including covered loans     | 5,948,324        | 5,714,360            | 5,459,426        | 233,964  | 488,898          |
| Total deposits                           | 6,895,250        | 6,766,101            | 6,866,747        | 129,149  | 28,503           |
| Transactional deposits                   | 5,748,699        | 5,558,318            | 5,555,489        | 190,381  | 193,210          |
| Loans-to-deposits ratio                  | 86.3             | % 84.5               | % 79.5           | %  |                  |
| Transactional deposits to total deposits | 83.4             | % 82.1               | % 80.9           | %  |                  |

|   | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 | June 30, 2014<br>Change From<br>December 31,<br>2013 | June 30,<br>2013 |
|---|------------------|----------------------|------------------|--|------------------|
| <b>Asset Quality Highlights</b>   |                  |                      |                  |  |                  |
| Non-accrual loans <sup>(1)</sup>  | \$66,728         | \$59,798             | \$89,193         | \$6,930  | \$(22,465 )      |
| 90 days or more past due loans (still accruing interest) <sup>(1)</sup> | 3,533            | 3,708                | 3,832            | (175 )   | (299 )           |
| Total non-performing loans <sup>(1)</sup>                               | 70,261           | 63,506               | 93,025           | 6,755  | (22,764 )        |
| Accruing troubled debt restructurings ("TDRs") <sup>(1)</sup>           | 5,697            | 23,770               | 8,287            | (18,073 )  | (2,590 )         |
| OREO <sup>(1)</sup>   | 30,331           | 32,473               | 39,497           | (2,142 )   | (9,166 )         |
| Total non-performing assets <sup>(1)</sup>                              | \$106,289        | \$119,749            | \$140,809        | \$(13,460 )  | \$(34,520 )      |
| 30-89 days past due loans (still accruing interest) <sup>(1)</sup>      | \$24,167         | \$20,742             | \$21,756         | \$3,425  | \$2,411          |
| Performing potential problem loans <sup>(1)(2)</sup>                    | 173,005          | 155,954              | 190,877          | 17,051   | (17,872 )        |
| Allowance for credit losses   | 79,942           | 87,121               | 96,976           | (7,179 )   | (17,034 )        |
| Allowance for credit losses to loans                                    | 1.34             | % 1.52               | % 1.78           | %  |                  |
| Allowance for credit losses to loans <sup>(1)</sup>                     | 1.21             | % 1.34               | % 1.56           | %  |                  |
| Allowance for credit losses to non-accrual loans <sup>(1)</sup>         | 105.80           | % 124.69             | % 92.60          | %  |                  |

Excludes covered loans and covered OREO. For a discussion of covered loans and covered OREO, refer to Note 5 <sup>(1)</sup> of "Notes to Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q. Asset quality, including covered loans and covered OREO, is included in the "Loan Portfolio and Credit Quality" section below.

<sup>(2)</sup> Total performing potential problem loans excludes accruing TDRs of \$3.6 million as of June 30, 2014, \$2.8 million as of December 31, 2013, and \$2.8 million as of June 30, 2013.

Net income for the second quarter of 2014 was \$18.5 million, or \$0.25 per share, compared to \$16.2 million, or \$0.22 per share, for the second quarter of 2013. For the first six months of 2014, net income was \$36.2 million, or \$0.48 per

share, compared to \$30.8 million, or \$0.41 per share, for the same period in 2013.

The growth in net income from the second quarter of 2013 resulted primarily from a \$1.4 million rise in net interest income and a \$3.8 million increase in noninterest income. For the first six months of 2014, the rise in net income benefited from a \$3.4 million increase in noninterest income as well as a \$4.7 million reduction in the provision for loan and covered loan losses. Compared to both prior periods, growth in noninterest income more than offset higher levels of noninterest expense that included \$830,000 of expenses related to recently announced, pending acquisitions. A discussion of net interest income, noninterest income, and noninterest expense is presented in the following section titled "Earnings Performance."

Total loans, excluding covered loans, of \$5.8 billion rose by \$263.5 million, or 9.4% on an annualized basis, from December 31, 2013. Both corporate and consumer loan portfolios continue to benefit from well-balanced growth distributed across the majority of the categories, reflecting credits of varying size within our market footprint.

Non-performing assets, excluding covered loans and covered OREO, decreased \$13.5 million, or 11.2%, from December 31, 2013, due primarily to lower levels of accruing TDRs. Non-accrual loans increased \$6.9 million from December 31, 2013 and declined \$22.5 million from June 30, 2013. Two accruing TDRs totaling \$18.8 million were returned to performing status due to sustained payment performance in accordance with their modified terms, which represent market rates at the time of restructuring. Performing potential problem loans were 3.42% of corporate loans at June 30, 2014, compared to 3.23% at December 31, 2013 and 4.16% at June 30, 2013. Refer to the “Loan Portfolio and Credit Quality” section below for further discussion of our loan portfolio, non-accrual loans, 90 days past due loans, TDRs, OREO, and performing potential problem loans.

## EARNINGS PERFORMANCE

### Net Interest Income

Net interest income is our primary source of revenue and is impacted by interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities. The accounting policies for the recognition of interest income on loans, securities, and other interest-earning assets are presented in Note 1 to the Consolidated Financial Statements of our 2013 10-K.

Our accounting and reporting policies conform to GAAP and general practices within the banking industry. For purposes of this discussion, both net interest income and net interest margin have been adjusted to a fully tax-equivalent basis to more appropriately compare the returns on certain tax-exempt loans and securities to those on taxable interest-earning assets. Although we believe that these non-GAAP financial measures enhance investors’ understanding of our business and performance, they should not be considered an alternative to GAAP. The effect of this adjustment is at the bottom of Tables 2 and 3.

Table 2 summarizes our average interest-earning assets and interest-bearing liabilities for the quarters ended June 30, 2014 and 2013, the related interest income and interest expense for each earning asset category and funding source, and the average interest rates earned and paid. Table 2 also details differences in interest income and expense from the prior quarter and the extent to which any changes are attributable to volume and rate fluctuations. Table 3 presents this same information for the six months ended June 30, 2014 and 2013.

Table 2  
Net Interest Income and Margin Analysis  
(Dollar amounts in thousands)

|  | Quarters Ended June 30,<br>2014 |          |                       | 2013               |          |                       | Attribution of Change<br>in Net Interest Income <sup>(1)</sup> |                |          |
|--|---------------------------------|----------|-----------------------|--------------------|----------|-----------------------|--|----------------|----------|
|  | Average<br>Balance              | Interest | Yield/<br>Rate<br>(%) | Average<br>Balance | Interest | Yield/<br>Rate<br>(%) | Volume   | Yield/<br>Rate | Total    |
| Assets:                                      |                                 |          |                       |                    |          |                       |  |                |          |
| Other interest-earning assets                | \$532,900                       | \$369    | 0.28                  | \$674,849          | \$468    | 0.28                  | \$(69 )  | \$(30 )        | \$(99 )  |
| Trading securities                           | 17,913                          | 28       | 0.63                  | 15,610             | 24       | 0.61                  | 4  | —              | 4        |
| Investment securities <sup>(2)</sup>         | 1,113,201                       | 10,256   | 3.69                  | 1,256,813          | 10,164   | 3.23                  | (421 )   | 513            | 92       |
| FHLB and Federal Reserve                     | 35,517                          | 348      | 3.92                  | 40,998             | 342      | 3.34                  | (20 )  | 26             | 6        |
| Bank stock                                   |                                 |          |                       |                    |          |                       |  |                |          |
| Loans <sup>(2)(3)</sup>                      | 5,902,953                       | 63,901   | 4.34                  | 5,383,891          | 63,829   | 4.76                  | 4,954  | (4,882 )       | 72       |
| Total interest-earning assets <sup>(2)</sup> | 7,602,484                       | 74,902   | 3.95                  | 7,372,161          | 74,827   | 4.07                  | 4,448  | (4,373 )       | 75       |
| Cash and due from banks                      | 117,108                         |          |                       | 124,996            |          |                       |  |                |          |
| Allowance for loan and covered loan losses   | (79,071 )                       |          |                       | (98,006 )          |          |                       |  |                |          |
| Other assets                                 | 776,148                         |          |                       | 860,502            |          |                       |  |                |          |
| Total assets                                 | \$8,416,669                     |          |                       | \$8,259,653        |          |                       |  |                |          |
| Liabilities and Stockholders' Equity:        |                                 |          |                       |                    |          |                       |  |                |          |
| Savings deposits                             | \$1,189,722                     | 203      | 0.07                  | \$1,144,093        | 208      | 0.07                  | 8  | (13 )          | (5 )     |
| NOW accounts                                 | 1,196,712                       | 152      | 0.05                  | 1,166,227          | 168      | 0.06                  | 4  | (20 )          | (16 )    |
| Money market deposits                        | 1,334,700                       | 365      | 0.11                  | 1,274,062          | 434      | 0.14                  | 22   | (91 )          | (69 )    |
| Time deposits                                | 1,168,898                       | 1,791    | 0.61                  | 1,331,499          | 2,193    | 0.66                  | (256 )   | (146 )         | (402 )   |
| Borrowed funds                               | 164,605                         | 169      | 0.41                  | 204,449            | 385      | 0.76                  | (153 )   | (63 )          | (216 )   |
| Senior and subordinated debt                 | 190,981                         | 3,016    | 6.33                  | 214,828            | 3,435    | 6.41                  | (377 )   | (42 )          | (419 )   |
| Total interest-bearing liabilities           | 5,245,618                       | 5,696    | 0.44                  | 5,335,158          | 6,823    | 0.51                  | (752 )   | (375 )         | (1,127 ) |
| Demand deposits                              | 2,069,781                       |          |                       | 1,880,476          |          |                       |  |                |          |
| Other liabilities                            | 66,681                          |          |                       | 83,518             |          |                       |  |                |          |
| Stockholders' equity - common                | 1,034,589                       |          |                       | 960,501            |          |                       |  |                |          |
| Total liabilities and stockholders' equity   | \$8,416,669                     |          |                       | \$8,259,653        |          |                       |  |                |          |
| Net interest income/margin <sup>(2)</sup>    |                                 | \$69,206 | 3.65                  |                    | \$68,004 | 3.70                  | \$5,200  | \$(3,998)      | \$1,202  |
| Net interest income (GAAP)                   |                                 | \$66,307 |                       |                    | \$64,930 |                       |  |                |          |
| Tax equivalent adjustment                    |                                 | 2,899    |                       |                    | 3,074    |                       |  |                |          |
| Tax-equivalent net interest income           |                                 | \$69,206 |                       |                    | \$68,004 |                       |  |                |          |

- (1) For purposes of this table, changes which are not due solely to volume changes or rate changes are allocated to these categories on the basis of the percentage relationship of each to the sum of the two.
- (2) Interest income and yields are presented on a tax-equivalent basis, assuming a federal income tax rate of 35%. This item includes covered interest-earning assets consisting of loans acquired through the Company's Federal
- (3) Deposit Insurance Corporation ("FDIC")-assisted transactions with loss share agreements and the related FDIC indemnification asset. For additional discussion, please refer to Note 5 of "Notes to the Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q.



Table 3  
Net Interest Income and Margin Analysis  
(Dollar amounts in thousands)

|  | Six Months Ended June 30,<br>2014 |           |                       | 2013               |           |                       | Attribution of Change<br>in Net Interest Income <sup>(1)</sup> |                |          |
|--|-----------------------------------|-----------|-----------------------|--------------------|-----------|-----------------------|--|----------------|----------|
|  | Average<br>Balance                | Interest  | Yield/<br>Rate<br>(%) | Average<br>Balance | Interest  | Yield/<br>Rate<br>(%) | Volume   | Yield/<br>Rate | Total    |
| Assets:                                      |                                   |           |                       |                    |           |                       |  |                |          |
| Other interest-earning assets                | \$535,007                         | \$751     | 0.28                  | \$629,761          | \$902     | 0.29                  | \$(88 )  | \$(64 )        | \$(152 ) |
| Trading securities                           | 17,693                            | 56        | 0.63                  | 14,987             | 60        | 0.80                  | 20   | (24 )          | (4 )     |
| Investment securities <sup>(2)</sup>         | 1,140,351                         | 20,658    | 3.62                  | 1,216,163          | 20,104    | 3.31                  | (1,030 )   | 1,584          | 554      |
| FHLB and Federal Reserve                     | 35,341                            | 683       | 3.87                  | 44,098             | 681       | 3.09                  | (8 )   | 10             | 2        |
| Bank stock                                   |                                   |           |                       |                    |           |                       |  |                |          |
| Loans <sup>(2)(3)</sup>                      | 5,813,203                         | 125,420   | 4.35                  | 5,377,995          | 127,279   | 4.77                  | 8,207  | (10,066 )      | (1,859)  |
| Total interest-earning assets <sup>(2)</sup> | 7,541,595                         | 147,568   | 3.94                  | 7,283,004          | 149,026   | 4.12                  | 7,101  | (8,560 )       | (1,459)  |
| Cash and due from banks                      | 114,319                           |           |                       | 117,576            |           |                       |  |                |          |
| Allowance for loan and covered loan losses   | (82,878 )                         |           |                       | (98,543 )          |           |                       |  |                |          |
| Other assets                                 | 776,913                           |           |                       | 863,961            |           |                       |  |                |          |
| Total assets                                 | \$8,349,949                       |           |                       | \$8,165,998        |           |                       |  |                |          |
| Liabilities and Stockholders' Equity:        |                                   |           |                       |                    |           |                       |  |                |          |
| Savings deposits                             | \$1,174,765                       | 405       | 0.07                  | \$1,125,755        | 455       | 0.08                  | 21   | (71 )          | (50 )    |
| NOW accounts                                 | 1,189,047                         | 322       | 0.05                  | 1,155,912          | 343       | 0.06                  | 11   | (32 )          | (21 )    |
| Money market deposits                        | 1,323,412                         | 785       | 0.12                  | 1,262,712          | 904       | 0.14                  | 46   | (165 )         | (119 )   |
| Time deposits                                | 1,182,598                         | 3,596     | 0.61                  | 1,352,894          | 4,621     | 0.69                  | (548 )   | (477 )         | (1,025)  |
| Borrowed funds                               | 193,388                           | 552       | 0.58                  | 202,183            | 827       | 0.82                  | (175 )   | (100 )         | (275 )   |
| Senior and subordinated debt                 | 190,965                           | 6,031     | 6.37                  | 214,812            | 6,870     | 6.45                  | (754 )   | (85 )          | (839 )   |
| Total interest-bearing liabilities           | 5,254,175                         | 11,691    | 0.45                  | 5,314,268          | 14,020    | 0.53                  | (1,399 )   | (930 )         | (2,329)  |
| Demand deposits                              | 1,999,426                         |           |                       | 1,811,036          |           |                       |  |                |          |
| Other liabilities                            | 71,299                            |           |                       | 86,379             |           |                       |  |                |          |
| Stockholders' equity - common                | 1,025,049                         |           |                       | 954,315            |           |                       |  |                |          |
| Total liabilities and stockholders' equity   | \$8,349,949                       |           |                       | \$8,165,998        |           |                       |  |                |          |
| Net interest income/margin <sup>(2)</sup>    |                                   | \$135,877 | 3.63                  |                    | \$135,006 | 3.73                  | \$8,500  | \$(7,630)      | \$870    |
| Net interest income (GAAP)                   |                                   | \$130,002 |                       |                    | \$128,778 |                       |  |                |          |
| Tax equivalent adjustment                    |                                   | 5,875     |                       |                    | 6,228     |                       |  |                |          |
| Tax-equivalent net interest                  |                                   | \$135,877 |                       |                    | \$135,006 |                       |  |                |          |

income

- (1) For purposes of this table, changes which are not due solely to volume changes or rate changes are allocated to these categories on the basis of the percentage relationship of each to the sum of the two.
- (2) Interest income and yields are presented on a tax-equivalent basis, assuming a federal income tax rate of 35%. This item includes covered interest-earning assets consisting of loans acquired through the Company's Federal Deposit Insurance Corporation ("FDIC")-assisted transactions with loss share agreements and the related FDIC indemnification asset. For additional discussion, please refer to Note 5 of "Notes to the Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q.
- (3)

Total interest-earning assets for the second quarter of 2014 increased by \$230.3 million from the second quarter of 2013 and \$258.6 million for the first six months of 2014 compared to the same period in 2013. The rise compared to both prior periods was driven by growth in the loan portfolio, which was funded by other interest-earning assets, cash flows from maturities of investment securities, and the increase in core deposits, which consists of demand, savings, NOW accounts, and money market deposits.

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The reduction in interest-bearing liabilities for both periods resulted primarily from lower levels of time deposits and the repurchase and retirement of \$24.0 million of junior subordinated debentures with a rate of 6.95% during the fourth quarter of 2013, which mitigated the impact of the rise in interest-bearing transaction deposits. The decline in borrowed funds resulted from the prepayment of \$114.6 million of FHLB advances with a weighted-average rate of 1.33% during the second quarter of 2014. Growth in demand deposits also contributed to the increase in total funding sources.

Growth in core deposits of \$326.1 million and \$331.2 million for the second quarter of 2014 and first six months of 2014, respectively, compared to both prior periods was driven by an increase in the average balances of select customer segments. This growth more than offset the decline in higher-cost time deposits and borrowed funds.

Tax-equivalent net interest margin for the second quarter and first six months of 2014 was 3.65% and 3.63%, respectively, a decline of 5 basis points from the second quarter of 2013 and 10 basis points from the first six months of 2013. The reduction in net interest margin compared to both prior periods reflects the decrease in the yield on loans driven by the flattening of the yield curve, the competitive market environment, and a continued shift in the loan mix to floating rate loans. This decline was partially offset by higher yields on investment securities, a reduction in higher cost borrowed funds, and growth in core deposits. Compared to the second quarter of 2013, the decrease in loan yield was partially mitigated by an increase in the yield on covered interest-earning assets.

#### Noninterest Income

A summary of noninterest income for the quarters and six months ended June 30, 2014 and 2013 is presented in the following table.

Table 4  
Noninterest Income Analysis  
(Dollar amounts in thousands)

|   | Quarters Ended   |          |          | Six Months Ended |          |          |
|---|------------------|----------|----------|------------------|----------|----------|
|   | June 30,<br>2014 | 2013     | % Change | June 30,<br>2014 | 2013     | % Change |
| Service charges on deposit accounts                         | \$8,973          | \$9,118  | (1.6 )   | \$16,993         | \$17,795 | (4.5 )   |
| Wealth management fees                                      | 6,552            | 6,126    | 7.0      | 13,009           | 11,965   | 8.7      |
| Card-based fees <sup>(1)</sup>                              | 5,969            | 5,547    | 7.6      | 11,304           | 10,623   | 6.4      |
| Merchant servicing fees <sup>(2)</sup>                      | 2,916            | 2,899    | 0.6      | 5,625            | 5,453    | 3.2      |
| Mortgage banking income                                     | 959              | 1,010    | (5.0 )   | 2,074            | 2,978    | (30.4 )  |
| Other service charges, commissions, and fees <sup>(2)</sup> | 1,639            | 1,308    | 25.3     | 3,052            | 2,952    | 3.4      |
| Total fee-based revenues                                    | 27,008           | 26,008   | 3.8      | 52,057           | 51,766   | 0.6      |
| Net securities gains  | 4,517            | 216      | N/M      | 5,590            | 216      | N/M      |
| Loss on early extinguishment of debt                        | (2,059 )         | —        | N/M      | (2,059 )         | —        | N/M      |
| Other income <sup>(3)(5)</sup>                              | 1,196            | 1,003    | 19.2     | 2,133            | 1,784    | 19.6     |
| Net trading gains <sup>(4)(5)</sup>                         | 531              | 214      | N/M      | 722              | 1,250    | (42.2 )  |
| Total noninterest income                                    | \$31,193         | \$27,441 | 13.7     | \$58,443         | \$55,016 | 6.2      |

N/M - Not meaningful.

Card-based fees consist of debit and credit card interchange fees for processing transactions as well as various fees

<sup>(1)</sup> on both customer and non-customer automated teller machine (“ATM”) and point-of-sale transactions processed through the ATM and point-of-sale networks.

<sup>(2)</sup>

These line items are included in other service charges, commissions, and fees in the Condensed Consolidated Statements of Income.

(3) Other income consists of various items, including safe deposit box rentals, miscellaneous recoveries, and gains on the sales of various assets.

Net trading gains result from changes in the fair value of diversified investment securities held in a grantor trust under deferred compensation arrangements and are substantially offset by nonqualified plan expense for each period presented.

(5) These line items are included in other income in the Condensed Consolidated Statements of Income.

Fee-based revenues continue to be strong driven by increases in wealth management fees, card-based fees, and merchant servicing fees. Total noninterest income of \$31.2 million grew \$3.8 million, or 13.7%, compared to the second quarter of 2013. For the first six months of 2014, total noninterest income rose 6.2%, from the same period in 2013.

A lower volume of non-sufficient funds transactions contributed to the decrease in service charges on deposit accounts compared to the six months ended June 30, 2013.

Wealth management fees increased 7.0% from the second quarter of 2013 and 8.7% from the first six months of 2013 due to a 15.4% rise in assets under management driven by new customer relationships.

Compared to both prior periods presented, the growth in card-based fees was due to increased transaction volumes.

During the second quarter and first six months of 2014, we sold \$32.2 million and \$83.0 million of 1-4 family mortgage loans, respectively, compared to \$28.0 million and \$82.0 million of loans sold during the same periods in 2013. Lower market pricing contributed to the decline in mortgage banking income compared to the prior year periods.

Net securities gains during the second quarter of 2014 resulted from a \$3.5 million gain on the sale of a non-accrual CDO, a \$518,000 gain on the sale of a portion of the Company's hedge fund investment, and a \$468,000 gain on the sale of municipal securities.

The \$2.1 million loss on early extinguishment of debt resulted from the prepayment of \$114.6 million in FHLB advances with a weighted average rate of 1.33% during the second quarter of 2014.

## Noninterest Expense

A summary of noninterest expense for the quarters and six months ended June 30, 2014 and 2013 is presented in the following table.

Table 5  
Noninterest Expense Analysis  
(Dollar amounts in thousands)

|   | Quarters Ended |          |             | Six Months Ended |           |             |
|---|----------------|----------|-------------|------------------|-----------|-------------|
|   | June 30,       |          | %<br>Change | June 30,         |           | %<br>Change |
|   | 2014           | 2013     |             | 2014             | 2013      |             |
| Salaries and employee benefits:           |                |          |             |                  |           |             |
| Salaries and wages                        | \$27,853       | \$26,553 | 4.9         | \$55,050         | \$54,392  | 1.2         |
| Nonqualified plan expense <sup>(1)</sup>  | 550            | 267      | N/M         | 736              | 1,391     | (47.1 )     |
| Retirement and other employee benefits    | 6,158          | 6,101    | 0.9         | 12,266           | 13,707    | (10.5 )     |
| Total salaries and employee benefits      | 34,561         | 32,921   | 5.0         | 68,052           | 69,490    | (2.1 )      |
| Net occupancy and equipment expense       | 7,672          | 7,793    | (1.6 )      | 17,063           | 15,940    | 7.0         |
| Professional services:                    |                |          |             |                  |           |             |
| Loan remediation costs                    | 2,238          | 2,547    | (12.1 )     | 4,229            | 4,686     | (9.8 )      |
| Other professional services               | 4,279          | 3,048    | 40.4        | 7,677            | 6,127     | 25.3        |
| Professional services                     | 6,517          | 5,595    | 16.5        | 11,906           | 10,813    | 10.1        |
| Technology and related costs              | 3,104          | 2,884    | 7.6         | 6,178            | 5,367     | 15.1        |
| Net OREO expense                          | 1,569          | 1,084    | 44.7        | 3,125            | 2,883     | 8.4         |
| Advertising and promotions <sup>(2)</sup> | 2,307          | 2,033    | 13.5        | 3,920            | 3,443     | 13.9        |
| Merchant card expense <sup>(2)</sup>      | 2,383          | 2,321    | 2.7         | 4,596            | 4,365     | 5.3         |
| Cardholder expenses <sup>(2)</sup>        | 1,081          | 1,043    | 3.6         | 2,095            | 1,972     | 6.2         |
| Other expenses <sup>(2)</sup>             | 5,823          | 6,753    | (13.8 )     | 11,750           | 12,968    | (9.4 )      |
| Total noninterest expense                 | \$65,017       | \$62,427 | 4.1         | \$128,685        | \$127,241 | 1.1         |
| Efficiency ratio <sup>(3)</sup>           | 63.60          | % 64.27  | %           | 65.09            | % 65.38   | %           |

N/M - Not meaningful.

Nonqualified plan expense results from changes in the Company's obligation to participants under deferred

<sup>(1)</sup> compensation agreements and is substantially offset by earnings on related assets, which are reported as net trading gains and included in noninterest income.

<sup>(2)</sup> These line items are included in other expense in the Condensed Consolidated Statements of Income.

The efficiency ratio expresses noninterest expense, excluding OREO expense, as a percentage of tax-equivalent net interest income plus total fee-based revenues, other income, net trading gains, and tax-equivalent adjusted BOLI

<sup>(3)</sup> income. Net securities gains are excluded from the efficiency ratio. The \$2.1 million loss on the prepayment of FHLB advances and \$830,000 of acquisition-related expenses are excluded from the efficiency ratio for the quarter and six months ended June 30, 2014.

The Company's efficiency ratio improved from 64.27% for the second quarter of 2013 to 63.60% compared to the same period in 2014. Total noninterest expense for the second quarter of 2014 increased 4.1% from the second quarter of 2013 and 1.1% for the first six months of 2014 compared to the same period in 2013. The rise in total noninterest expense compared to both prior periods presented was impacted by costs associated with increased sales production

and \$830,000 in professional services expenses related to the recently announced, pending acquisitions. Excluding these acquisition-related expenses, total noninterest expense approximated the first six months of 2013.

Compared to both prior periods presented, the increase in salaries and wages expense resulted primarily from the timing of certain incentive compensation accruals.

Retirement and other employee benefits expense decreased compared to the first six months of 2013 primarily resulting from the changes to the Company's defined benefit pension plan instituted in the second quarter of 2013, which was partially offset by an increase in other employee benefit accruals.

Net occupancy and equipment expense was elevated in the first quarter of 2014 due to higher utilities and snow removal costs during the first quarter of 2014.

Compared to both prior periods presented, the decrease in loan remediation costs was driven by lower servicing costs for our covered loan portfolio and a reduction in real estate taxes paid to preserve the Company's rights to collateral associated with problem loans.

As discussed above, increased legal expenses primarily related to acquisition activity drove the rise in other professional services expense for the second quarter and first six months of 2014 compared to the same periods in 2013. Higher levels of personnel recruitment expenses also contributed to the increase compared to the first six months of 2013.

The increase in net OREO expense compared to the second quarter of 2013 was driven by higher levels of OREO valuation adjustments recorded in the second quarter of 2014, which was partially offset by a decrease in closing cost expenses from fewer sales.

Advertising and promotions expense increased from the second quarter and first six months of 2013 due to the timing of certain advertising costs.

Higher levels of other expenses in the second quarter and first six months of 2013 resulted from recording \$750,000 and \$1.5 million, respectively, in adjusted amortization of the FDIC indemnification asset. No adjusted amortization of the FDIC indemnification asset was required during 2014 based on management's current estimates of future cash flows on covered loans.

#### Income Taxes

Our provision for income taxes includes both federal and state income tax expense. An analysis of the provision for income taxes is detailed in the following table.

Table 6  
Income Tax Expense Analysis  
(Dollar amounts in thousands)

|                                  | Quarters Ended   |          | Six Months Ended |          |   |
|----------------------------------|------------------|----------|------------------|----------|---|
|                                  | June 30,<br>2014 | 2013     | June 30,<br>2014 | 2013     |   |
| Income before income tax expense | \$27,142         | \$24,131 | \$52,978         | \$45,066 |   |
| Income tax expense:              |                  |          |                  |          |   |
| Federal income tax expense       | \$6,727          | \$5,553  | \$13,005         | \$9,913  |   |
| State income tax expense         | 1,915            | 2,402    | 3,809            | 4,335    |   |
| Total income tax expense         | \$8,642          | \$7,955  | \$16,814         | \$14,248 |   |
| Effective income tax rate        | 31.8             | % 33.0   | % 31.7           | % 31.6   | % |

Federal income tax expense and the related effective income tax rate are influenced by the amount of tax-exempt income derived from investment securities and BOLI in relation to pre-tax income and state income taxes. State income tax expense and the related effective tax rate are driven by the amount of state tax-exempt income in relation to pre-tax income and state tax rules related to consolidated/combined reporting and sourcing of income and expense.

The decrease in the effective income tax rate of 31.8% for the second quarter of 2014 compared to 33.0% for the same period in 2013 was due primarily to a decrease in state income tax expense, resulting from an increase in income exempt from state taxes and a decrease in statutory rates.



Our accounting policies for the recognition of income taxes in the Consolidated Statements of Financial Condition and Income are included in Notes 1 and 14 to the Consolidated Financial Statements of our 2013 10-K.

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## FINANCIAL CONDITION

## Investment Portfolio Management

Securities that we have the positive intent and ability to hold until maturity are classified as securities held-to-maturity and are accounted for using historical cost, adjusted for amortization of premiums and accretion of discounts. Trading securities are carried at fair value with changes in fair value included in other noninterest income. Our trading securities consist of securities held in a grantor trust for our nonqualified deferred compensation plan and are not considered part of the traditional investment portfolio. All other securities are classified as securities available-for-sale and are carried at fair value with unrealized gains and losses, net of related deferred income taxes, recorded in stockholders' equity as a separate component of accumulated other comprehensive loss.

We manage our investment portfolio to maximize the return on invested funds within acceptable risk guidelines, to meet pledging and liquidity requirements, and to adjust balance sheet interest rate sensitivity to mitigate the impact of changes in interest rates on net interest income.

From time to time, we adjust the size and composition of our securities portfolio based on a number of factors, including expected loan growth, anticipated changes in collateralized public funds on account, the interest rate environment, and the related value of various segments of the securities markets. The following table provides a valuation summary of our investment portfolio.

Table 7

## Investment Portfolio Valuation Summary

(Dollar amounts in thousands)

|  | June 30, 2014  |                               |            |            | December 31, 2013 |                               |            |            |
|--|----------------|-------------------------------|------------|------------|-------------------|-------------------------------|------------|------------|
|  | Amortized Cost | Net Unrealized Gains (Losses) | Fair Value | % of Total | Amortized Cost    | Net Unrealized Gains (Losses) | Fair Value | % of Total |
| Securities Available-for-Sale                |                |                               |            |            |                   |                               |            |            |
| U.S. agency securities                       | \$500          | \$1                           | \$501      | 0.1        | \$500             | \$—                           | \$500      | —          |
| Collateralized mortgage obligations ("CMOs") | 448,337        | (6,872 )                      | 441,465    | 41.0       | 490,962           | (15,194 )                     | 475,768    | 41.2       |
| Other mortgage-backed securities ("MBSs")    | 123,787        | 3,705                         | 127,492    | 11.8       | 135,097           | 1,067                         | 136,164    | 11.8       |
| Municipal securities                         | 432,187        | 11,698                        | 443,885    | 41.2       | 457,318           | 4,075                         | 461,393    | 39.9       |
| CDOs   | 45,023         | (26,587 )                     | 18,436     | 1.7        | 46,532            | (28,223 )                     | 18,309     | 1.6        |
| Corporate debt securities                    | 12,995         | 2,240                         | 15,235     | 1.4        | 12,999            | 1,930                         | 14,929     | 1.3        |
| Equity securities                            | 2,904          | 557                           | 3,461      | 0.3        | 3,706             | 1,956                         | 5,662      | 0.5        |
| Total available-for-sale securities          | 1,065,733      | (15,258 )                     | 1,050,475  | 97.5       | 1,147,114         | (34,389 )                     | 1,112,725  | 96.3       |
| Securities Held-to-Maturity                  | 26,471         | 605                           | 27,076     | 2.5        | 44,322            | (935 )                        | 43,387     | 3.7        |

Municipal securities

|                  |             |            |             |       |             |            |             |       |
|------------------|-------------|------------|-------------|-------|-------------|------------|-------------|-------|
| Total securities | \$1,092,204 | \$(14,653) | \$1,077,551 | 100.0 | \$1,191,436 | \$(35,324) | \$1,156,112 | 100.0 |
|------------------|-------------|------------|-------------|-------|-------------|------------|-------------|-------|

Portfolio Composition

As of June 30, 2014, our securities portfolio totaled \$1.1 billion, decreasing 6.8% compared to December 31, 2013. The reduction in CMOs and municipal securities from December 31, 2013 resulted from maturities, calls, and prepayments of \$82.8 million, which were offset by purchases of \$11.1 million.

Approximately 96.5% of our available-for-sale securities portfolio is comprised of U.S. agency securities, CMOs, other MBSs, and municipal securities. The remainder of the portfolio consists of five CDOs with a total fair value of \$18.4 million and miscellaneous other securities with fair values of \$18.7 million.

Investments in municipal securities comprised 42.3%, or \$443.9 million, of the total available-for-sale securities portfolio at June 30, 2014. The majority consists of general obligations of local municipalities. Our municipal securities portfolio has historically experienced very low default rates and provides a predictable cash flow.

Table 8  
Securities Effective Duration Analysis  
(Dollar amounts in thousands)

|                                      | June 30, 2014                     |                             |                                  | December 31, 2013                 |                             |                                  |   |
|--------------------------------------|-----------------------------------|-----------------------------|----------------------------------|-----------------------------------|-----------------------------|----------------------------------|---|
|                                      | Effective Duration <sup>(1)</sup> | Average Life <sup>(2)</sup> | Yield to Maturity <sup>(3)</sup> | Effective Duration <sup>(1)</sup> | Average Life <sup>(2)</sup> | Yield to Maturity <sup>(3)</sup> |   |
| <b>Securities Available-for-Sale</b> |                                   |                             |                                  |                                   |                             |                                  |   |
| U.S. agency securities               | 1.74                              | % 1.75                      | 0.49                             | % 2.23                            | % 2.25                      | 0.49                             | % |
| CMOs                                 | 3.85                              | % 3.87                      | 1.83                             | % 4.48                            | % 4.26                      | 1.86                             | % |
| Other MBSs                           | 3.33                              | % 4.35                      | 2.94                             | % 3.93                            | % 4.85                      | 2.45                             | % |
| Municipal securities                 | 3.79                              | % 2.76                      | 5.52                             | % 5.11                            | % 3.27                      | 5.53                             | % |
| CDOs                                 | N/M                               | N/M                         | N/M                              | N/M                               | N/M                         | N/M                              |   |
| Corporate debt securities            | 4.73                              | % 6.87                      | 6.40                             | % 4.86                            | % 7.18                      | 6.39                             | % |
| Equity securities                    | N/M                               | N/M                         | N/M                              | N/M                               | N/M                         | N/M                              |   |
| Total available-for-sale securities  | 3.77                              | % 3.49                      | 3.59                             | % 4.68                            | % 3.95                      | 3.52                             | % |
| <b>Securities Held-to-Maturity</b>   |                                   |                             |                                  |                                   |                             |                                  |   |
| Municipal securities                 | 5.77                              | % 8.34                      | 4.45                             | % 6.50                            | % 11.84                     | 5.47                             | % |
| Total securities                     | 3.82                              | % 3.61                      | 3.61                             | % 4.75                            | % 4.26                      | 3.60                             | % |

N/M - Not meaningful.

The effective duration represents the estimated percentage change in the fair value of the securities portfolio given a 100 basis point increase or decrease in interest rates. This measure is used to evaluate the portfolio's price volatility at a single point in time and is not intended to be a precise predictor of future fair values since those values will be influenced by a number of factors.

- (1) Average life is presented in years and represents the weighted-average time to receive half of all future cash flows using the dollar amount of principal paydowns, including estimated principal prepayments, as the weighting factor.
- (2) Yields on municipal securities are reflected on a tax-equivalent basis, assuming a federal income tax rate of 35%.

#### Effective Duration

The average life and effective duration of our available-for-sale securities portfolio as of June 30, 2014 declined from the December 31, 2013 metrics due to maturities of investment securities that were not reinvested in the securities portfolio. The yield to maturity of our available-for-sale securities portfolio as of June 30, 2014 is consistent with the December 31, 2013 metrics.

#### Securities Gains and Losses

Net securities gains for the second quarter and first six months of 2014 were \$4.5 million and \$5.6 million, respectively. During the second quarter of 2014, we sold a non-accrual CDO with a carrying value of \$1.3 million at a gain of \$3.5 million and \$5.0 million of municipal securities at gains totaling \$468,000. In addition, we sold a portion of the Company's hedge fund investment at gains of \$1.1 million and \$518,000, respectively. There were no impairment charges recognized during the second quarter and first six months of 2014.

Net securities gains for the second quarter and first six months of 2013 were \$216,000, resulting from sales of \$19.5 million in CMOs, other MBSs, and a CDO.

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## Unrealized Gains and Losses

Unrealized gains and losses on securities available-for-sale represent the difference between the aggregate cost and fair value of the portfolio. These amounts are presented in the Consolidated Statements of Comprehensive Income and reported as a separate component of stockholders' equity in accumulated other comprehensive loss on an after-tax basis. This balance sheet component will fluctuate as current market interest rates and conditions change and affect the aggregate fair value of the portfolio. Net unrealized losses were \$15.3 million at June 30, 2014 compared to \$34.4 million at December 31, 2013.

Net unrealized losses in the CMO portfolio totaled \$6.9 million at June 30, 2014 compared to \$15.2 million at December 31, 2013. CMOs are either backed by U.S. government-owned agencies or issued by U.S. government-sponsored enterprises. We do not believe any individual unrealized loss on this type of security as of June 30, 2014 represents other-than-temporary securities impairment ("OTTI") since the unrealized losses are not believed to be attributed to credit quality.

As of June 30, 2014, net unrealized gains in the municipal securities portfolio totaled \$11.7 million compared to \$4.1 million as of December 31, 2013. Net unrealized gains on municipal securities include unrealized losses of \$1.6 million at June 30, 2014. Substantially all of these securities carry investment grade ratings with the majority supported by the general revenues of the issuing governmental entity and are supported by third party bond insurance or other types of credit enhancement. We do not believe the unrealized loss on any of these securities represents OTTI.

Our investments in CDOs are supported by the credit of the underlying banks and insurance companies. The unrealized losses on these securities declined from \$28.2 million at December 31, 2013 to \$26.6 million at June 30, 2014. We do not believe the unrealized losses on the CDOs as of June 30, 2014 represent OTTI related to credit deterioration. In addition, we do not intend to sell the CDOs with unrealized losses within a short period of time, and we do not believe it is more likely than not that we will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Our estimation of fair values for the CDOs is based on discounted cash flow analyses as described in Note 11 of "Notes to the Condensed Consolidated Financial Statements," in Part I, Item 1 of this Form 10-Q.

## LOAN PORTFOLIO AND CREDIT QUALITY

### Loans Held-for-Investment

Our loan portfolio is comprised of both corporate and consumer loans with corporate loans representing 86.6% of total loans, excluding covered loans, at June 30, 2014. Consistent with our emphasis on relationship banking, the majority of our loans are made to our core, multi-relationship customers. The customers usually maintain deposit relationships and utilize our other banking services, such as cash management or wealth management services.

To maximize loan income within an acceptable level of risk, we have certain lending policies and procedures that management reviews on a regular basis. In addition, management receives periodic reporting related to loan production, loan quality, credit concentrations, loan delinquencies, and non-performing and performing potential problem loans to mitigate and monitor potential and current risks in the portfolio. We do not offer any sub-prime products and we have policies to limit our exposure to any single borrower.

### Commercial, Industrial, and Agricultural Loans

Commercial, industrial, and agricultural loans represent 41.1% of total loans, excluding covered loans, and totaled \$2.4 billion at June 30, 2014, an increase of \$251.3 million, or 23.4% annualized, from December 31, 2013. Our

commercial and industrial loans are a diverse group of loans to community-based and middle market businesses generally located in the Chicago metropolitan area with purposes that range from supporting seasonal working capital needs to term financing of equipment. The underwriting for these loans is based primarily on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Most commercial and industrial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may incorporate a personal guarantee.

Agricultural loans are generally provided to meet seasonal production, equipment, and farm real estate borrowing needs of individual and corporate crop and livestock producers. As part of the underwriting process, the Company examines projected cash flows, financial statement stability, and the value of the underlying collateral. Seasonal crop production loans are repaid by the liquidation of the financed crop that is typically covered by crop insurance. Equipment and real estate term loans are repaid through cash flows of the farming operation.

## Commercial Real Estate Loans

Commercial real estate loans represent 45.5% of total loans, excluding covered loans, and totaled \$2.7 billion at June 30, 2014, consistent with December 31, 2013. Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans. The repayment of commercial real estate loans depends on the successful operation of the property securing the loan or the business conducted on the property securing the loan. This category of loans may be more adversely affected by conditions in the real estate market. Management monitors and evaluates commercial real estate loans based on cash flow, collateral, geography, and risk rating criteria. The mix of properties securing the loans in our commercial real estate portfolio are balanced between owner-occupied and investor categories and represent varying types across our market footprint.

Construction loans are generally based on estimates of costs and values associated with the completed projects and are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analyses of absorption and lease rates, and financial analyses of the developers and property owners. Sources of repayment may be permanent loans from long-term lenders, sales of developed property, or an interim loan commitment until permanent financing is obtained. Generally, construction loans have a higher risk profile than other real estate loans since repayment is impacted by real estate values, interest rate changes, governmental regulation of real property, demand and supply of alternative real estate, the availability of long-term financing, and changes in general economic conditions.

## Consumer Loans

Consumer loans represent 13.4% of total loans, excluding covered loans, and totaled \$783.5 million at June 30, 2014, an increase of \$35.7 million from December 31, 2013. Consumer loans are centrally underwritten using a credit scoring model developed by the Fair Isaac Corporation (“FICO”). It uses a risk-based system to determine the probability that a borrower may default on financial obligations to the lender. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include loan-to-value and affordability ratios, risk-based pricing strategies, and documentation requirements. The home equity category consists mainly of revolving lines of credit secured by junior liens on owner-occupied real estate. Loan-to-value ratios on home equity loans and 1-4 family mortgages are based on the current appraised value of the collateral.

Table 9

### Loan Portfolio

(Dollar amounts in thousands)

|                              | June 30,<br>2014 | % of<br>Total | December 31,<br>2013 | % of<br>Total | Annualized<br>% Change |
|------------------------------|------------------|---------------|----------------------|---------------|------------------------|
| Commercial and industrial    | \$2,073,018      | 35.5          | \$1,830,638          | 32.8          | 26.5                   |
| Agricultural                 | 330,626          | 5.6           | 321,702              | 5.8           | 5.5                    |
| Commercial real estate:      |                  |               |                      |               |                        |
| Office                       | 444,956          | 7.6           | 459,202              | 8.2           | (6.2 )                 |
| Retail                       | 377,427          | 6.5           | 392,576              | 7.0           | (7.7 )                 |
| Industrial                   | 490,018          | 8.4           | 501,907              | 9.0           | (4.7 )                 |
| Multi-family                 | 350,430          | 6.0           | 332,873              | 6.0           | 10.5                   |
| Construction                 | 195,109          | 3.3           | 186,197              | 3.3           | 9.6                    |
| Other commercial real estate | 798,324          | 13.7          | 807,071              | 14.5          | (2.2 )                 |
| Total commercial real estate | 2,656,264        | 45.5          | 2,679,826            | 48.0          | (1.8 )                 |
| Total corporate loans        | 5,059,908        | 86.6          | 4,832,166            | 86.6          | 9.4                    |
| Home equity                  | 485,085          | 8.3           | 427,020              | 7.7           | 27.2                   |
| 1-4 family mortgages         | 241,156          | 4.1           | 275,992              | 4.9           | (25.2 )                |
| Installment                  | 57,308           | 1.0           | 44,827               | 0.8           | 55.7                   |
| Total consumer loans         | 783,549          | 13.4          | 747,839              | 13.4          | 9.6                    |



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|                                      |             |       |             |       |        |   |
|--------------------------------------|-------------|-------|-------------|-------|--------|---|
| Total loans, excluding covered loans | 5,843,457   | 100.0 | 5,580,005   | 100.0 | 9.4    |   |
| Covered loans                        | 104,867     |       | 134,355     |       | (43.9) | ) |
| Total loans                          | \$5,948,324 |       | \$5,714,360 |       | 8.2    |   |

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Total loans, excluding covered loans, of \$5.8 billion rose by \$263.5 million, or 9.4% on an annualized basis, from December 31, 2013. Both corporate and consumer loan portfolios continue to benefit from well-balanced growth distributed across the majority of loan categories, reflecting credits of varying size within our market footprint. Strong growth in the commercial and industrial and agricultural loan categories reflects the impact of greater resource investments and expansion into certain sector-based lending areas, such as agri-business, asset-based lending, and healthcare.

During the six months ended June 30, 2014, total consumer loans grew 9.6% on an annualized basis from December 31, 2013. The 1-4 family mortgage portfolio reflects the sale of \$83.0 million of 1-4 family mortgage loans. Compared to December 31, 2013, the 27.2% annualized increase in the home equity portfolio reflects organic growth and the purchase of \$48.7 million of high quality, shorter-duration, floating rate loans.

The following table presents commercial real estate loan detail.

Table 10

Commercial Real Estate Loans  
(Dollar amounts in thousands)

|   | June 30,<br>2014 | % of<br>Total | December 31,<br>2013 | % of<br>Total |
|---|------------------|---------------|----------------------|---------------|
| Office, retail, and industrial:   |                  |               |                      |               |
| Office  | \$444,956        | 16.8          | \$459,202            | 17.1          |
| Retail  | 377,427          | 14.2          | 392,576              | 14.7          |
| Industrial  | 490,018          | 18.4          | 501,907              | 18.7          |
| Total office, retail, and industrial  | 1,312,401        | 49.4          | 1,353,685            | 50.5          |
| Multi-family  | 350,430          | 13.2          | 332,873              | 12.4          |
| Construction  | 195,109          | 7.3           | 186,197              | 7.0           |
| Other commercial real estate  |                  |               |                      |               |
| Rental properties   | 109,498          | 4.1           | 112,887              | 4.2           |
| Service stations and truck stops  | 72,333           | 2.7           | 83,237               | 3.1           |
| Warehouses and storage  | 127,423          | 4.8           | 122,325              | 4.6           |
| Hotels  | 54,811           | 2.1           | 62,451               | 2.3           |
| Restaurants   | 72,027           | 2.7           | 79,809               | 3.0           |
| Automobile dealers  | 35,149           | 1.3           | 37,504               | 1.4           |
| Recreational  | 51,896           | 2.0           | 56,327               | 2.1           |
| Religious   | 31,085           | 1.2           | 32,614               | 1.2           |
| Multi-use properties  | 149,360          | 5.6           | 118,351              | 4.4           |
| Other   | 94,742           | 3.6           | 101,566              | 3.8           |
| Total other commercial real estate  | 798,324          | 30.1          | 807,071              | 30.1          |
| Total commercial real estate  | \$2,656,264      | 100.0         | \$2,679,826          | 100.0         |
| Owner-occupied commercial real estate loans,<br>excluding multi-family and construction loans | \$878,972        |               | \$933,151            |               |
| Owner-occupied as a percent of total,<br>excluding multi-family and construction loans        | 41.6             | %             | 43.2                 | %             |

Commercial real estate loans represent 45.5% of total loans, excluding covered loans. Nearly half of our commercial real estate loans consist of loans for industrial buildings, office buildings, and retail shopping centers. The mix of properties securing the loans in our commercial real estate portfolio continues to be balanced between owner-occupied and investor categories as of June 30, 2014.



## Non-performing Assets and Performing Potential Problem Loans

The following table presents our loan portfolio by performing and non-performing status. A discussion of our accounting policies for non-accrual loans, TDRs, and loans 90 days or more past due can be found in Note 1 of “Notes to the Condensed Consolidated Financial Statements” in Part 1, Item 1 of this Form 10-Q.

Table 11

## Loan Portfolio by Performing/Non-Performing Status

(Dollar amounts in thousands)

|                                      | Total<br>Loans | Current     | Accruing<br>30-89 Days<br>Past Due | 90 Days<br>Past Due | TDRs    | Non-accrual |
|--------------------------------------|----------------|-------------|------------------------------------|---------------------|---------|-------------|
| As of June 30, 2014                  |                |             |                                    |                     |         |             |
| Commercial and industrial            | \$2,073,018    | \$2,037,767 | \$7,691                            | \$2,207             | \$2,724 | \$22,629    |
| Agricultural                         | 330,626        | 330,177     | 86                                 | —                   | —       | 363         |
| Commercial real estate:              |                |             |                                    |                     |         |             |
| Office                               | 444,956        | 438,583     | 4,541                              | —                   | —       | 1,832       |
| Retail                               | 377,427        | 367,606     | 467                                | —                   | —       | 9,354       |
| Industrial                           | 490,018        | 484,603     | —                                  | —                   | 178     | 5,237       |
| Multi-family                         | 350,430        | 347,382     | 625                                | 231                 | 620     | 1,572       |
| Construction                         | 195,109        | 187,761     | 2,271                              | —                   | —       | 5,077       |
| Other commercial real estate         | 798,324        | 786,032     | 3,238                              | 676                 | 448     | 7,930       |
| Total commercial real estate         | 2,656,264      | 2,611,967   | 11,142                             | 907                 | 1,246   | 31,002      |
| Total corporate loans                | 5,059,908      | 4,979,911   | 18,919                             | 3,114               | 3,970   | 53,994      |
| Home equity                          | 485,085        | 474,543     | 3,035                              | 91                  | 836     | 6,580       |
| 1-4 family mortgages                 | 241,156        | 234,046     | 1,831                              | 297                 | 891     | 4,091       |
| Installment                          | 57,308         | 54,832      | 382                                | 31                  | —       | 2,063       |
| Total consumer loans                 | 783,549        | 763,421     | 5,248                              | 419                 | 1,727   | 12,734      |
| Total loans, excluding covered loans | 5,843,457      | 5,743,332   | 24,167                             | 3,533               | 5,697   | 66,728      |
| Covered loans                        | 104,867        | 77,057      | 6,286                              | 8,464               | —       | 13,060      |
| Total loans                          | \$5,948,324    | \$5,820,389 | \$30,453                           | \$11,997            | \$5,697 | \$79,788    |
| As of December 31, 2013              |                |             |                                    |                     |         |             |
| Commercial and industrial            | \$1,830,638    | \$1,805,516 | \$6,424                            | \$393               | \$6,538 | \$11,767    |
| Agricultural                         | 321,702        | 321,123     | 60                                 | —                   | —       | 519         |
| Commercial real estate:              |                |             |                                    |                     |         |             |
| Office                               | 459,202        | 455,547     | 1,200                              | 731                 | —       | 1,724       |
| Retail                               | 392,576        | 385,234     | 939                                | 272                 | 624     | 5,507       |
| Industrial                           | 501,907        | 481,766     | 337                                | 312                 | 9,647   | 9,845       |
| Multi-family                         | 332,873        | 329,669     | 318                                | —                   | 1,038   | 1,848       |
| Construction                         | 186,197        | 179,877     | 23                                 | —                   | —       | 6,297       |
| Other commercial real estate         | 807,071        | 789,517     | 4,817                              | 258                 | 4,326   | 8,153       |
| Total commercial real estate         | 2,679,826      | 2,621,610   | 7,634                              | 1,573               | 15,635  | 33,374      |
| Total corporate loans                | 4,832,166      | 4,748,249   | 14,118                             | 1,966               | 22,173  | 45,660      |
| Home equity                          | 427,020        | 413,912     | 4,355                              | 1,102               | 787     | 6,864       |
| 1-4 family mortgages                 | 275,992        | 267,497     | 1,939                              | 548                 | 810     | 5,198       |
| Installment                          | 44,827         | 42,329      | 330                                | 92                  | —       | 2,076       |
| Total consumer loans                 | 747,839        | 723,738     | 6,624                              | 1,742               | 1,597   | 14,138      |
| Total loans, excluding covered loans | 5,580,005      | 5,471,987   | 20,742                             | 3,708               | 23,770  | 59,798      |

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|               |             |             |          |          |          |          |
|---------------|-------------|-------------|----------|----------|----------|----------|
| Covered loans | 134,355     | 93,100      | 2,232    | 18,081   | —        | 20,942   |
| Total loans   | \$5,714,360 | \$5,565,087 | \$22,974 | \$21,789 | \$23,770 | \$80,740 |

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The following table provides a comparison of our non-performing assets and past due loans to prior periods.

Table 12  
Non-Performing Assets and Past Due Loans  
(Dollar amounts in thousands)

|   | 2014      |           | 2013        |              |           |   |
|---|-----------|-----------|-------------|--------------|-----------|---|
|   | June 30   | March 31  | December 31 | September 30 | June 30   |   |
| Non-performing assets, excluding covered loans and covered OREO |           |           |             |              |           |   |
| Non-accrual loans   | \$66,728  | \$64,217  | \$59,798    | \$68,170     | \$89,193  |   |
| 90 days or more past due loans                                  | 3,533     | 4,973     | 3,708       | 5,642        | 3,832     |   |
| Total non-performing loans                                      | 70,261    | 69,190    | 63,506      | 73,812       | 93,025    |   |
| Accruing TDRs   | 5,697     | 6,301     | 23,770      | 24,329       | 8,287     |   |
| OREO  | 30,331    | 30,026    | 32,473      | 35,616       | 39,497    |   |
| Total non-performing assets                                     | \$106,289 | \$105,517 | \$119,749   | \$133,757    | \$140,809 |   |
| 30-89 days past due loans                                       | \$24,167  | \$12,861  | \$20,742    | \$15,111     | \$21,756  |   |
| Non-accrual loans to total loans                                | 1.14      | % 1.13    | % 1.07      | % 1.25       | % 1.69    | % |
| Non-performing loans to total loans                             | 1.20      | % 1.22    | % 1.14      | % 1.35       | % 1.76    | % |
| Non-performing assets to loans plus OREO                        | 1.81      | % 1.84    | % 2.13      | % 2.44       | % 2.64    | % |
| Non-performing covered loans and covered OREO <sup>(1)</sup>    |           |           |             |              |           |   |
| Non-accrual loans   | \$13,060  | \$18,004  | \$20,942    | \$30,856     | \$28,468  |   |
| 90 days or more past due loans                                  | 8,464     | 14,691    | 18,081      | 20,235       | 27,700    |   |
| Total non-performing loans                                      | 21,524    | 32,695    | 39,023      | 51,091       | 56,168    |   |
| OREO  | 9,825     | 7,355     | 8,863       | 10,477       | 13,681    |   |
| Total non-performing assets                                     | \$31,349  | \$40,050  | \$47,886    | \$61,568     | \$69,849  |   |
| 30-89 days past due loans                                       | \$6,286   | \$2,439   | \$2,232     | \$7,881      | \$5,650   |   |
| Non-performing assets, including covered loans and covered OREO |           |           |             |              |           |   |
| Non-accrual loans   | \$79,788  | \$82,221  | \$80,740    | \$99,026     | \$117,661 |   |
| 90 days or more past due loans                                  | 11,997    | 19,664    | 21,789      | 25,877       | 31,532    |   |
| Total non-performing loans                                      | 91,785    | 101,885   | 102,529     | 124,903      | 149,193   |   |
| Accruing TDRs   | 5,697     | 6,301     | 23,770      | 24,329       | 8,287     |   |
| OREO  | 40,156    | 37,381    | 41,336      | 46,093       | 53,178    |   |
| Total non-performing assets                                     | \$137,638 | \$145,567 | \$167,635   | \$195,325    | \$210,658 |   |
| 30-89 days past due loans                                       | \$30,453  | \$15,300  | \$22,974    | \$22,992     | \$27,406  |   |
| Non-accrual loans to total loans                                | 1.34      | % 1.41    | % 1.41      | % 1.77       | % 2.16    | % |
| Non-performing loans to total loans                             | 1.54      | % 1.75    | % 1.79      | % 2.23       | % 2.73    | % |
| Non-performing assets to loans plus OREO                        | 2.30      | % 2.49    | % 2.91      | % 3.46       | % 3.82    | % |

Covered loans and covered OREO are covered by FDIC Agreements that substantially mitigate the risk of loss.

Past due covered loans in the tables above are determined by borrower performance compared to contractual terms,

<sup>(1)</sup> but are generally considered accruing loans since they continue to perform in accordance with our expectations of cash flows. For a discussion of covered loans and covered OREO, refer to Note 5 of "Notes to the Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q.

Non-performing assets, excluding covered loans and covered OREO, decreased \$13.5 million, or 11.2%, from December 31, 2013, due primarily to lower levels of accruing TDRs, which was partially offset by a rise in non-accrual loans. Two accruing TDRs totaling \$18.8 million were returned to performing status due to sustained payment performance in accordance with their modified terms, which represent market rates at the time of restructuring. Refer to the "TDRs" section below for further discussion.

The majority of loans 30-89 days past due at June 30, 2014 were in the process of renewal.

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## TDRs

Loan modifications may be performed at the request of the individual borrower and may include reductions in interest rates, changes in payments, and extensions of maturity dates. We occasionally restructure loans at other than market rates or terms to enable the borrower to work through financial difficulties for a period of time, and these restructures remain classified as TDRs for the remaining terms of the loans.

Table 13

## TDRs by Type

(Dollar amounts in thousands)

|                                   | June 30, 2014   |         | December 31, 2013 |          | June 30, 2013   |          |
|-----------------------------------|-----------------|---------|-------------------|----------|-----------------|----------|
|                                   | Number of Loans | Amount  | Number of Loans   | Amount   | Number of Loans | Amount   |
| Commercial and industrial         | 5               | \$3,001 | 10                | \$8,659  | 9               | \$16,394 |
| Agricultural                      | —               | —       | —                 | —        | —               | —        |
| Commercial real estate:           |                 |         |                   |          |                 |          |
| Office                            | —               | —       | —                 | —        | —               | —        |
| Retail                            | —               | —       | 2                 | 624      | 2               | 628      |
| Industrial                        | 1               | 178     | 3                 | 9,647    | 1               | 365      |
| Multi-family                      | 4               | 862     | 5                 | 1,291    | 5               | 1,317    |
| Construction                      | —               | —       | —                 | —        | 2               | 500      |
| Other commercial real estate      | 6               | 636     | 7                 | 4,617    | 8               | 5,303    |
| Total commercial real estate      | 11              | 1,676   | 17                | 16,179   | 18              | 8,113    |
| Total corporate loans             | 16              | 4,677   | 27                | 24,838   | 27              | 24,507   |
| Home equity                       | 19              | 1,353   | 18                | 1,299    | 7               | 380      |
| 1-4 family mortgages              | 11              | 1,367   | 14                | 1,716    | 15              | 1,850    |
| Installment                       | —               | —       | —                 | —        | —               | —        |
| Total consumer loans              | 30              | 2,720   | 32                | 3,015    | 22              | 2,230    |
| Total TDRs                        | 46              | \$7,397 | 59                | \$27,853 | 49              | \$26,737 |
| Accruing TDRs                     | 31              | \$5,697 | 39                | \$23,770 | 23              | \$8,287  |
| Non-accrual TDRs                  | 15              | 1,700   | 20                | 4,083    | 26              | 18,450   |
| Total TDRs                        | 46              | \$7,397 | 59                | \$27,853 | 49              | \$26,737 |
| Year-to-date charge-offs on TDRs  |                 | \$152   |                   | \$1,880  |                 | \$1,788  |
| Specific reserves related to TDRs |                 | —       |                   | 1,952    |                 | 2,195    |

TDRs totaled \$7.4 million at June 30, 2014, decreasing \$20.5 million from December 31, 2013.

Accruing TDRs declined \$18.1 million from December 31, 2013 driven primarily by the return of two TDRs totaling \$18.8 million to performing status during the first quarter of 2014 due to sustained payment performance in accordance with their modified terms, which represent market rates at the time of restructuring. This reduction was partially offset by the addition of two corporate loan relationships totaling \$2.0 million that were upgraded to accruing TDR status.

At June 30, 2014, non-accrual TDRs totaled \$1.7 million compared to \$4.1 million at December 31, 2013. TDRs are reported as non-accrual if they are not yet performing in accordance with their modified terms or they have not yet exhibited sufficient performance under their modified terms. The decrease in non-accrual TDRs from December 31, 2013 was driven primarily by the upgrade of two non-accrual TDRs to accruing TDR status discussed above.





## Performing Potential Problem Loans

Performing potential problem loans consist of special mention loans and substandard loans. These loans are performing in accordance with contractual terms, but we have concerns about the ability of the borrower to continue to comply with loan terms due to the borrower's operating or financial difficulties.

Table 14  
Performing Potential Problem Loans  
(Dollar amounts in thousands)

|   | June 30, 2014                  |                            |                      | December 31, 2013              |                            |                      |   |
|---|--------------------------------|----------------------------|----------------------|--------------------------------|----------------------------|----------------------|---|
|   | Special Mention <sup>(1)</sup> | Substandard <sup>(2)</sup> | Total <sup>(3)</sup> | Special Mention <sup>(1)</sup> | Substandard <sup>(2)</sup> | Total <sup>(3)</sup> |   |
| Commercial and industrial                             | \$50,036                       | \$17,106                   | \$67,142             | \$23,679                       | \$14,135                   | \$37,814             |   |
| Agricultural  | 298                            | —                          | 298                  | 344                            | —                          | 344                  |   |
| Commercial real estate:                               |                                |                            |                      |                                |                            |                      |   |
| Office, retail, and industrial                        | 24,055                         | 20,831                     | 44,886               | 27,871                         | 23,538                     | 51,409               |   |
| Multi-family  | 3,446                          | 717                        | 4,163                | 2,794                          | 499                        | 3,293                |   |
| Construction  | 8,790                          | 16,453                     | 25,243               | 8,309                          | 17,642                     | 25,951               |   |
| Other commercial real estate                          | 15,918                         | 15,355                     | 31,273               | 14,567                         | 22,576                     | 37,143               |   |
| Total commercial real estate                          | 52,209                         | 53,356                     | 105,565              | 53,541                         | 64,255                     | 117,796              |   |
| Total performing potential problem loans              | \$102,543                      | \$70,462                   | \$173,005            | \$77,564                       | \$78,390                   | \$155,954            |   |
| Performing potential problem loans to corporate loans | 2.03                           | % 1.39                     | % 3.42               | % 1.61                         | % 1.62                     | % 3.23               | % |

(1) Loans categorized as special mention exhibit potential weaknesses that require the close attention of management since these potential weaknesses may result in the deterioration of repayment prospects in the future.

(2) Loans categorized as substandard exhibit a well-defined weakness or weaknesses that may jeopardize the liquidation of the debt. These loans continue to accrue interest because they are well secured and collection of principal and interest is expected within a reasonable time.

(3) Total performing potential problem loans excludes accruing TDRs of \$3.6 million as of June 30, 2014 and \$2.8 million as of December 31, 2013.

Performing potential problem loans were 3.42% of corporate loans at June 30, 2014, compared to 3.23% at December 31, 2013, and down from 4.16% at June 30, 2013. Compared to December 31, 2013, these levels reflect a greater proportion of loans classified as special mention. Overall, shifts in the categories are subject to borrower circumstances and closer monitoring plans by management to facilitate recovery.



## OREO

OREO consists of properties acquired as the result of borrower defaults on loans. OREO, excluding covered OREO, was \$30.3 million at June 30, 2014, decreasing \$2.1 million from December 31, 2013.

Table 15  
OREO Properties by Type  
(Dollar amounts in thousands)

|                                    | June 30, 2014        |          | December 31, 2013    |          | June 30, 2013        |          |
|------------------------------------|----------------------|----------|----------------------|----------|----------------------|----------|
|                                    | Number of Properties | Amount   | Number of Properties | Amount   | Number of Properties | Amount   |
| Single family homes                | 18                   | \$ 1,982 | 29                   | \$ 2,257 | 31                   | \$ 3,388 |
| Land parcels:                      |                      |          |                      |          |                      |          |
| Raw land                           | 8                    | 3,843    | 6                    | 4,037    | 5                    | 3,244    |
| Commercial lots                    | 17                   | 11,485   | 17                   | 11,649   | 21                   | 12,356   |
| Single-family lots                 | 26                   | 1,634    | 22                   | 3,101    | 24                   | 3,163    |
| Total land parcels                 | 51                   | 16,962   | 45                   | 18,787   | 50                   | 18,763   |
| Multi-family units                 | 7                    | 868      | 4                    | 346      | 13                   | 976      |
| Commercial properties              | 23                   | 10,519   | 23                   | 11,083   | 29                   | 16,370   |
| Total OREO, excluding covered OREO | 99                   | 30,331   | 101                  | 32,473   | 123                  | 39,497   |
| Covered OREO                       | 38                   | 9,825    | 48                   | 8,863    | 59                   | 13,681   |
| Total OREO properties              | 137                  | \$40,156 | 149                  | \$41,336 | 182                  | \$53,178 |

## OREO Activity

The following table summarizes disposals of OREO for the six months ended June 30, 2014 and 2013.

Table 16  
OREO Disposals and Write-Downs  
(Dollar amounts in thousands)

|                                | Six Months Ended<br>June 30, 2014 |              |         | June 30, 2013 |              |          |
|--------------------------------|-----------------------------------|--------------|---------|---------------|--------------|----------|
|                                | OREO                              | Covered OREO | Total   | OREO          | Covered OREO | Total    |
| OREO sales                     |                                   |              |         |               |              |          |
| Proceeds from sales            | \$3,697                           | \$5,463      | \$9,160 | \$7,035       | \$3,872      | \$10,907 |
| Less: Basis of properties sold | (3,090)                           | (5,363)      | (8,453) | (6,989)       | (3,825)      | (10,814) |
| Net gains on sales of OREO     | \$(607)                           | \$(100)      | \$(707) | \$(46)        | \$(47)       | \$(93)   |
| OREO valuation adjustments     | \$2,066                           | \$—          | \$2,066 | \$555         | \$31         | \$586    |

For the six months ended June 30, 2014, we sold \$3.1 million of OREO, excluding covered OREO, which consisted of 40 properties with the majority classified as single-family homes.

OREO sales, excluding covered OREO, for the six months ended June 30, 2013, consisted of 33 properties with the majority in the single-family home and commercial property categories.



## Allowance for Credit Losses

### Methodology for the Allowance for Credit Losses

The allowance for credit losses is comprised of the allowance for loan and covered loan losses and the reserve for unfunded commitments and is maintained by management at a level believed adequate to absorb estimated losses inherent in the existing loan portfolio. Determination of the allowance for credit losses is inherently subjective since it requires significant estimates and management judgment, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans, and consideration of current economic trends.

While management utilizes its best judgment and information available, the ultimate adequacy of the allowance for credit losses depends on a variety of factors beyond the Company's control, including the performance of its loan portfolio, the economy, changes in interest rates and property values, and the interpretation of loan risk ratings by regulatory authorities. Management believes that the allowance for credit losses is an appropriate estimate of credit losses inherent in the loan portfolio as of June 30, 2014.

The accounting policy for the allowance for credit losses is discussed in Note 1 of "Notes to the Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q.

Table 17  
 Allowance for Credit Losses  
 and Summary of Credit Loss Experience  
 (Dollar amounts in thousands)

|  | Quarters Ended  |           |                     |              |           |
|--|-----------------|-----------|---------------------|--------------|-----------|
|  | 2014<br>June 30 | March 31  | 2013<br>December 31 | September 30 | June 30   |
| Change in allowance for credit losses                        |                 |           |                     |              |           |
| Beginning balance  | \$82,248        | \$87,121  | \$93,214            | \$96,976     | \$100,457 |
| Loan charge-offs:  |                 |           |                     |              |           |
| Commercial, industrial, and agricultural                     | 2,099           | 3,680     | 3,084               | 2,719        | 3,116     |
| Office, retail, and industrial                               | 3,511           | 1,083     | 1,042               | 987          | 1,453     |
| Multi-family   | 267             | 90        | 539                 | 112          | 213       |
| Construction   | 234             | 661       | 31                  | 470          | 850       |
| Other commercial real estate                                 | 561             | 1,771     | 813                 | 889          | 547       |
| Consumer   | 1,828           | 2,028     | 2,045               | 2,482        | 2,523     |
| Total loan charge-offs                                       | 8,500           | 9,313     | 7,554               | 7,659        | 8,702     |
| Recoveries of loan charge-offs:                              |                 |           |                     |              |           |
| Commercial, industrial, and agricultural                     | 259             | 2,160     | 614                 | 521          | 573       |
| Office, retail, and industrial                               | 290             | 58        | 160                 | 31           | 35        |
| Multi-family   | 2               | 1         | 549                 | —            | 30        |
| Construction   | 2               | 158       | 965                 | 60           | 5         |
| Other commercial real estate                                 | 89              | 144       | 37                  | 250          | 329       |
| Consumer   | 213             | 138       | 177                 | 374          | 413       |
| Total recoveries of loan charge-offs                         | 855             | 2,659     | 2,502               | 1,236        | 1,385     |
| Net loan charge-offs, excluding covered loan charge-offs     | 7,645           | 6,654     | 5,052               | 6,423        | 7,317     |
| Net covered loan charge-offs (recoveries)                    | 2               | (340)     | ) 271               | 1,629        | 1,977     |
| Net loan and covered loan charge-offs                        | 7,647           | 6,314     | 5,323               | 8,052        | 9,294     |
| Provision for loan and covered loan losses:                  |                 |           |                     |              |           |
| Provision for loan losses                                    | 7,425           | 2,911     | 226                 | 4,466        | 1,682     |
| Provision for covered loan losses                            | (2,084)         | ) (1,470) | ) (226)             | ) 304        | 4,131     |
| Total provision for loan and covered loan losses             | 5,341           | 1,441     | —                   | 4,770        | 5,813     |
| Reduction in reserve for unfunded commitments <sup>(1)</sup> | —               | —         | (770)               | ) (480)      | ) —       |
| Total provision for loan and covered loan losses and other   | 5,341           | 1,441     | (770)               | ) 4,290      | 5,813     |
| Ending balance   | \$79,942        | \$82,248  | \$87,121            | \$93,214     | \$96,976  |

<sup>(1)</sup> Included in other noninterest expense in the Consolidated Statements of Income.

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|   | Quarters Ended |             |             |              |             |   |
|---|----------------|-------------|-------------|--------------|-------------|---|
|   | 2014           |             | 2013        |              |             |   |
|   | June 30        | March 31    | December 31 | September 30 | June 30     |   |
| Allowance for credit losses                                   |                |             |             |              |             |   |
| Allowance for loan losses                                     | \$68,983       | \$69,203    | \$72,946    | \$77,772     | \$79,729    |   |
| Allowance for covered loan losses                             | 9,343          | 11,429      | 12,559      | 13,056       | 14,381      |   |
| Total allowance for loan and covered loan losses              | 78,326         | 80,632      | 85,505      | 90,828       | 94,110      |   |
| Reserve for unfunded commitments                              | 1,616          | 1,616       | 1,616       | 2,386        | 2,866       |   |
| Total allowance for credit losses                             | \$79,942       | \$82,248    | \$87,121    | \$93,214     | \$96,976    |   |
| Amounts and ratios, excluding covered loans                   |                |             |             |              |             |   |
| Average loans   | \$5,778,044    | \$5,578,616 | \$5,516,747 | \$5,379,435  | \$5,180,608 |   |
| Net loan charge-offs to average loans, annualized             | 0.53           | % 0.48      | % 0.36      | % 0.47       | % 0.57      | % |
| Allowance for credit losses at end of period as a percent of: |                |             |             |              |             |   |
| Total loans   | 1.21           | % 1.24      | % 1.34      | % 1.47       | % 1.56      | % |
| Non-accrual loans   | 105.80         | % 110.28    | % 124.69    | % 117.59     | % 92.60     | % |
| Non-performing loans  | 100.48         | % 102.35    | % 117.41    | % 108.60     | % 88.79     | % |
| Amounts and ratios, including covered loans                   |                |             |             |              |             |   |
| Average loans   | \$5,891,127    | \$5,706,880 | \$5,658,756 | \$5,539,776  | \$5,357,945 |   |
| Net loan charge-offs to average loans annualized              | 0.52           | % 0.45      | % 0.37      | % 0.58       | % 0.70      | % |
| Allowance for credit losses at end of period as a percent of: |                |             |             |              |             |   |
| Total loans   | 1.34           | % 1.41      | % 1.52      | % 1.66       | % 1.78      | % |
| Non-accrual loans   | 100.19         | % 100.03    | % 107.90    | % 94.13      | % 82.42     | % |
| Non-performing loans  | 87.10          | % 80.73     | % 84.97     | % 74.63      | % 65.00     | % |

#### Activity in the Allowance for Credit Losses

The allowance for credit losses was \$79.9 million as of June 30, 2014, a decline of \$7.2 million from December 31, 2013. The allowance for credit losses was 1.34% of total loans, including covered loans, at June 30, 2014 compared to 1.52% at December 31, 2013.

Net loan charge-offs declined 17.7% from the second quarter of 2013. In addition, net loan charge-offs to average loans, excluding covered loans, annualized, decreased 7.0%.

Covered loan charge-offs reflect the decline, and recoveries reflect the increase, in estimated cash flows of certain acquired loans. Management re-estimates cash flows periodically, and the present value of any decreases in expected cash flows from the FDIC is recorded as either a charge-off or an allowance for covered loan losses is established. Any increases in expected cash flows are recorded through the allowance for covered loan losses as recoveries to the extent charge-offs were previously taken or prospectively as yield adjustments over the remaining lives of the specific loans.





## FUNDING AND LIQUIDITY MANAGEMENT

The following table provides a comparison of average funding sources for the quarters ended June 30, 2014, December 31, 2013, and June 30, 2013. We believe that average balances, rather than period-end balances, are more meaningful in analyzing funding sources because of the normal fluctuations that may occur on a daily or monthly basis within funding categories.

Table 18  
Funding Sources – Average Balances  
(Dollar amounts in thousands)

|   | Quarters Ended   |                      |                  | Second Quarter 2014<br>% Change From |                           |    |
|---|------------------|----------------------|------------------|--------------------------------------|---------------------------|----|
|   | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 | Fourth<br>Quarter<br>2013            | Second<br>Quarter<br>2013 |    |
| Demand deposits                                 | \$2,069,781      | \$1,956,570          | \$1,880,476      | 5.8                                  | % 10.1                    | %  |
| Savings deposits                                | 1,189,722        | 1,126,737            | 1,144,093        | 5.6                                  | % 4.0                     | %  |
| NOW accounts                                    | 1,196,712        | 1,195,471            | 1,166,227        | 0.1                                  | % 2.6                     | %  |
| Money market accounts                           | 1,334,700        | 1,356,383            | 1,274,062        | (1.6)                                | )% 4.8                    | %  |
| Transactional deposits                          | 5,790,915        | 5,635,161            | 5,464,858        | 2.8                                  | % 6.0                     | %  |
| Time deposits                                   | 1,152,816        | 1,218,450            | 1,308,997        | (5.4)                                | )% (11.9)                 | )% |
| Brokered deposits                               | 16,082           | 16,067               | 22,502           | 0.1                                  | % (28.5)                  | )% |
| Total time deposits                             | 1,168,898        | 1,234,517            | 1,331,499        | (5.3)                                | )% (12.2)                 | )% |
| Total deposits                                  | 6,959,813        | 6,869,678            | 6,796,357        | 1.3                                  | % 2.4                     | %  |
| Securities sold under agreements to repurchase  | 104,183          | 99,207               | 89,880           | 5.0                                  | % 15.9                    | %  |
| FHLB advances                                   | 60,422           | 114,554              | 114,569          | (47.3)                               | )% (47.3)                 | )% |
| Total borrowed funds                            | 164,605          | 213,761              | 204,449          | (23.0)                               | )% (19.5)                 | )% |
| Senior and subordinated debt                    | 190,981          | 207,162              | 214,828          | (7.8)                                | )% (11.1)                 | )% |
| Total funding sources                           | \$7,315,399      | \$7,290,601          | \$7,215,634      | 0.3                                  | % 1.4                     | %  |
| Average interest rate paid on borrowed funds    | 0.41             | % 0.72               | % 0.76           | %                                    |                           |    |
| Weighted-average maturity of FHLB advances      | N/A              | 29.3 months          | 35.6 months      |                                      |                           |    |
| Weighted-average interest rate of FHLB advances | N/A              | 1.34                 | % 1.34           | %                                    |                           |    |

N/A - Not applicable.

Average funding sources for the second quarter of 2014 increased \$24.8 million from the fourth quarter of 2013 and increased \$99.8 million from the second quarter of 2013. Compared to both prior periods presented, the rise in transactional deposits more than offset the decrease in time deposits and the reduction in borrowed funds, which resulted from the prepayment of \$114.6 million in FHLB advances with a weighted-average rate of 1.33% during the second quarter of 2014. The reduction in average senior and subordinated debt compared to both prior quarters presented was due to the repurchase and retirement of \$24.0 million of junior subordinated debentures with a rate of 6.95% during the fourth quarter of 2013.



Table 19  
Borrowed Funds  
(Dollar amounts in thousands)

|   | June 30, 2014 |                           | June 30, 2013 |                           |
|---|---------------|---------------------------|---------------|---------------------------|
|   | Amount        | Weighted-Average Rate (%) | Amount        | Weighted-Average Rate (%) |
| At period-end:  |               |                           |               |                           |
| Securities sold under agreements to repurchase                      | \$ 104,201    | 0.03                      | \$ 82,038     | 0.03                      |
| FHLB advances   | —             | —                         | 114,565       | 1.34                      |
| Total borrowed funds  | \$ 104,201    | 0.03                      | \$ 196,603    | 0.79                      |
| Average for the year-to-date period:                                |               |                           |               |                           |
| Securities sold under agreements to repurchase                      | \$ 106,053    | 0.03                      | \$ 87,610     | 0.03                      |
| FHLB advances   | 87,335        | 1.24                      | 114,573       | 1.44                      |
| Total borrowed funds  | \$ 193,388    | 0.58                      | \$ 202,183    | 0.82                      |
| Maximum amount outstanding at the end of any day during the period: |               |                           |               |                           |
| Securities sold under agreements to repurchase                      | \$ 117,584    |                           | \$ 104,115    |                           |
| FHLB advances   | 114,551       |                           | 114,581       |                           |

Average borrowed funds totaled \$193.4 million for the first six months of 2014 decreasing 4.4% compared to the same period in 2013 due to the prepayment of \$114.6 million of FHLB advances during the second quarter of 2014. This decline was partially offset by higher levels of securities sold under agreements to repurchase.

Securities sold under agreements to repurchase generally mature within 1 to 90 days from the transaction date.

## MANAGEMENT OF CAPITAL

### Capital Measurements

A strong capital structure is required under applicable banking regulations and is crucial in maintaining investor confidence, accessing capital markets, and enabling us to take advantage of future growth opportunities. Our capital policy requires that the Company and the Bank maintain capital ratios in excess of the minimum regulatory guidelines. It serves as an internal discipline in analyzing business risks and internal growth opportunities and sets targeted levels of return on equity. Under regulatory capital adequacy guidelines, the Company and the Bank are subject to various capital requirements set and administered by the federal banking agencies. These requirements specify minimum capital ratios, defined as Tier 1 and total capital as a percentage of assets and off-balance sheet items that were weighted according to broad risk categories and a leverage ratio calculated as Tier 1 capital as a percentage of adjusted average assets. We manage our capital ratios for the Bank to consistently maintain these measurements in excess of the Federal Reserve's minimum levels to be considered "well-capitalized," which is the highest capital category established.

The following table presents our consolidated measures of capital as of the dates presented and the capital guidelines established by the Federal Reserve for the Bank to be categorized as "well-capitalized." All regulatory mandated ratios for characterization as "well-capitalized" were exceeded as of June 30, 2014 and December 31, 2013.

All other ratios presented in the table below are capital adequacy metrics used and relied on by investors and industry analysts; however, they are non-GAAP financial measures for SEC purposes. These non-GAAP measures are valuable indicators of a financial institution's capital strength since they eliminate intangible assets from stockholders' equity and retain the effect of accumulated other comprehensive loss in stockholders' equity. Reconciliations of the components of those ratios to GAAP are also presented in the table below.

Table 20  
Capital Measurements  
(Dollar amounts in thousands)

|  | June 30,<br>2014 | December 31,<br>2013 | Regulatory<br>Minimum<br>For<br>Well-<br>Capitalized | Excess Over<br>Required Minimums<br>at June 30, 2014 |             |
|--|------------------|----------------------|--|--|-------------|
| Bank regulatory capital ratios:  |                  |                      |  |  |             |
| Total capital to risk-weighted assets  | 13.37            | % 13.86              | % 10.00  | % 34   | % \$229,632 |
| Tier 1 capital to risk-weighted assets   | 12.20            | % 12.61              | % 6.00   | % 103  | % \$422,543 |
| Tier 1 leverage to average assets  | 10.37            | % 10.24              | % 5.00   | % 107  | % \$430,619 |
| Company regulatory capital ratios <sup>(1)</sup> :   |                  |                      |  |  |             |
| Total capital to risk-weighted assets  | 12.20            | % 12.39              | % N/A  | N/A  | N/A         |
| Tier 1 capital to risk-weighted assets   | 10.97            | % 10.91              | % N/A  | N/A  | N/A         |
| Tier 1 leverage to average assets  | 9.61             | % 9.18               | % N/A  | N/A  | N/A         |
| Company tier 1 common capital to risk-weighted assets <sup>(1)(2)</sup>                    | 10.45            | % 10.37              | % N/A  | N/A  | N/A         |
| Reconciliation of Company capital components to GAAP:                                      |                  |                      |  |  |             |
| Total stockholder's equity   | \$1,039,438      | \$1,001,442          |  |  |             |
| Goodwill and other intangible assets   | (274,962 )       | (276,366 )           |  |  |             |
| Tangible common equity   | 764,476          | 725,076              |  |  |             |
| Accumulated other comprehensive loss   | 15,271           | 26,792               |  |  |             |
| Tangible common equity, excluding accumulated other comprehensive loss                     | \$779,747        | \$751,868            |  |  |             |
| Total assets   | \$8,305,247      | \$8,253,407          |  |  |             |
| Goodwill and other intangible assets   | (274,962 )       | (276,366 )           |  |  |             |
| Tangible assets  | \$8,030,285      | \$7,977,041          |  |  |             |
| Risk-weighted assets   | \$7,116,591      | \$6,794,666          |  |  |             |
| Company tangible common equity ratios <sup>(1)(3)</sup> :                                  |                  |                      |  |  |             |
| Tangible common equity to tangible assets  | 9.52             | % 9.09               | % N/A  | N/A  | N/A         |
| Tangible common equity, excluding accumulated other comprehensive loss, to tangible assets | 9.71             | % 9.43               | % N/A  | N/A  | N/A         |
| Tangible common equity to risk-weighted assets   | 10.74            | % 10.67              | % N/A  | N/A  | N/A         |

N/A - Not applicable.

<sup>(1)</sup> Ratio is not subject to formal Federal Reserve regulatory guidance.

<sup>(2)</sup> Excludes the impact of trust-preferred securities.

Tangible common equity ("TCE") represents common stockholders' equity less goodwill and identifiable intangible assets. In management's view, Tier 1 common capital and TCE measures are meaningful to the Company, as well as analysts and investors, in assessing the Company's use of equity and in facilitating comparisons with competitors.

The decline in the Company's total capital to risk-weighted assets ratio compared to December 31, 2013 was due to an increase in risk-weighted assets resulting from loan growth, which more than offset the increase in total capital from

earnings for the first six months of 2014 and the increase in allowable deferred tax assets. The Company's tier 1 leverage to average assets ratio increased 43 basis points from December 31, 2013 driven by strong earnings and the increase in allowable deferred tax assets, which more than offset the increase in average assets. The Bank's regulatory ratios exceeded all regulatory mandated ratios for characterization as "well-capitalized" as of June 30, 2014.

The Board of Directors reviews the Company's capital plan each quarter, considering the current and expected operating environment as well as an evaluation of various capital alternatives.

#### Basel III Capital Rules

In July of 2013, the Company and the Bank's primary federal regulator, the Federal Reserve, published final rules establishing a new comprehensive capital framework for U.S. banking organizations. The Basel III Capital Rules are discussed in the "Supervision and Regulation" section in Item 1, "Business" in the Company's 2013 10-K. Management believes that as of June 30, 2014 the Company and the Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect.

#### Dividends

The Board of Directors approved an increase in the quarterly cash dividend from \$0.07 to \$0.08 per common share during the second quarter of 2014, which followed a dividend increase from \$0.04 to \$0.07 per common share in the fourth quarter of 2013.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates, and equity prices. Interest rate risk is our primary market risk and is the result of repricing, basis, and option risk. A description and analysis of our interest rate risk management policies is included in Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk," in our 2013 10-K.

We seek to achieve consistent growth in net interest income and net income while managing volatility that arises from shifts in interest rates. The Bank's Asset Liability Committee ("ALCO") oversees financial risk management by developing programs to measure and manage interest rate risks within authorized limits set by the Bank's Board of Directors. ALCO also approves the Bank's asset and liability management policies, oversees the formulation and implementation of strategies to improve balance sheet positioning and earnings, and reviews the Bank's interest rate sensitivity position. Management uses net interest income simulation modeling to analyze and capture exposure of earnings to changes in interest rates.

#### Net Interest Income Sensitivity

The analysis of net interest income sensitivity assesses the magnitude of changes in net interest income over a twelve-month measurement period resulting from immediate changes in interest rates using multiple rate scenarios. These scenarios include, but are not limited to, a flat or unchanged rate environment, immediate increases of 100, 200, and 300 basis points, and an immediate decrease of 100 basis points. Due to the low interest rate environment as of June 30, 2014 and December 31, 2013, management determined that an immediate decrease in interest rates greater than 100 basis points was not meaningful for this analysis.

This simulation analysis is based on estimated cash flows and repricing characteristics for balance sheet and off-balance sheet instruments and incorporates market-based assumptions regarding the effect of changing interest rates on the prepayment rates of certain assets and liabilities. In addition, this sensitivity analysis examines assets and liabilities at the beginning of the measurement period and does not assume any changes from growth or business plans over the next twelve months. Interest-earning assets and interest-bearing liabilities are assumed to re-price based on contractual terms over the twelve-month measurement period assuming an instantaneous parallel shift in interest rates in effect at the beginning of the measurement period. The simulation analysis also incorporates assumptions based on the historical behavior of deposit rates in relation to interest rates. Because these assumptions are inherently uncertain, the simulation analysis cannot definitively measure net interest income or predict the impact of the fluctuation in interest rates on net interest income, but does provide an indication of the Company's sensitivity to changes in interest



rates. Actual results may differ from simulated results due to timing, magnitude, and frequency of interest rate changes as well as changes in market conditions and management strategies.

Our balance sheet is asset sensitive based on repricing and maturity characteristics and simulation analysis assumptions. The Bank's current simulation analysis indicates we would benefit from rising interest rates.

Interest-earning assets consist of short and long-term products. As of June 30, 2014, 48% of the loan portfolio consisted of fixed rate loans and 52% were floating rate loans. Investments, consisting of securities and interest-bearing deposits in other banks, are more heavily weighted toward fixed rate securities at 70% of the total compared to 30% for floating rate interest-bearing deposits in other banks. Fixed rate loans are most sensitive to the 3-5 year portion of the yield curve and the Bank limits its loans with maturities that extend beyond 5 years. The majority of floating rate loans are indexed to the short-term Prime or LIBOR rates. The amount of floating rate loans with interest rate floors was \$704.5 million, or 28%, of the floating rate loan portfolio as of June 30, 2014. On the liability side of the

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balance sheet, 84% of deposits are demand deposits or interest-bearing transactional deposits, which either do not pay interest or the interest rates are expected to rise at a slower pace than short-term interest rates.

#### Analysis of Net Interest Income Sensitivity

(Dollar amounts in thousands)

|                    | Immediate Change in Rates |          |          |            |
|--------------------|---------------------------|----------|----------|------------|
|                    | +300                      | +200     | +100     | -100       |
| June 30, 2014:     |                           |          |          |            |
| Dollar change      | \$41,744                  | \$26,160 | \$11,035 | \$(10,474) |
| Percent change     | 16.0                      | % 10.0   | % 4.2    | % (4.0)    |
| December 31, 2013: |                           |          |          |            |
| Dollar change      | \$45,209                  | \$28,307 | \$11,925 | \$(11,791) |
| Percent change     | 17.3                      | % 10.8   | % 4.6    | % (4.5)    |

The sensitivity of estimated net interest income to an instantaneous parallel shift in interest rate changes is reflected as both dollar and percent changes. For example, this table illustrates that an instantaneous 200 basis point rise in interest rates as of June 30, 2014 would increase net interest income by \$26.2 million, or 10.0%, over the next twelve months compared to no change in interest rates. This same measure was \$28.3 million, or 10.8%, as of December 31, 2013, which suggests that the Company was slightly less sensitive to rising rates at June 30, 2014 compared to December 31, 2013.

During the six months ended June 30, 2014, floating rate loan balances increased and were funded by an increase in core deposits and a decrease in investments. Overall, this increase in rate sensitive assets was offset by the prepayment of \$114.6 million of FHLB advances at fixed rates and the hedging of \$125.0 million of certain corporate variable rate loans using interest rate swaps through which we receive fixed amounts and pay variable amounts. While net interest income is projected to decline in a decreasing interest rate environment, we believe the risk of a significant decrease in interest rates is minimal.

#### ITEM 4. CONTROLS AND PROCEDURES

At the end of the period covered by this report, (the "Evaluation Date"), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer and its Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, the President and Chief Executive Officer and Executive Vice President and Chief Financial Officer concluded that as of the Evaluation Date, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no changes in the Company's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

#### PART II. OTHER INFORMATION

##### ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of business, there were certain legal proceedings pending against the Company and its subsidiaries at June 30, 2014. While the outcome of any legal proceeding is inherently uncertain, based on information currently available, the Company's management believes that any liabilities arising from pending legal matters are not expected to have a material adverse effect on the Company's financial position, results of operations, or cash flows.

ITEM 1A. RISK FACTORS

The Company provided a discussion of certain risks and uncertainties faced by the Company in its Annual Report on Form 10-K for 2013. However, these factors may not be the only risks or uncertainties the Company faces.

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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table summarizes the Company's monthly Common Stock purchases during the second quarter of 2014. The Board approved a stock repurchase program on November 27, 2007. Up to 2.5 million shares of the Company's Common Stock may be repurchased, and the total remaining authorization under the program was 2,494,747 shares as of June 30, 2014. The repurchase program has no set expiration or termination date.

## Issuer Purchases of Equity Securities

|                          | Total<br>Number of<br>Shares<br>Purchased <sup>(1)</sup> | Average<br>Price<br>Paid per<br>Share | Total Number<br>of Shares<br>Purchased as<br>Part of a<br>Publicly<br>Announced<br>Plan or<br>Program | Maximum<br>Number of<br>Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plan or<br>Program |
|--------------------------|--|---------------------------------------|---|---|
| April 1 – April 30, 2014 | —  | \$—                                   | —   | 2,494,747   |
| May 1 – May 31, 2014     | 2,577  | 15.91                                 | —   | 2,494,747   |
| June 1 – June 30, 2014   | —  | —                                     | —   | 2,494,747   |
| Total                    | 2,577  | \$15.91                               | —   |   |

Consists of shares acquired pursuant to the Company's share-based compensation plans and not the Company's stock repurchase program. Under the terms of these plans, the Company accepts shares of Common Stock from <sup>(1)</sup> option holders if they elect to surrender previously owned shares upon exercise to cover the exercise price of the stock options or, in the case of restricted shares of Common Stock, the withholding of shares to satisfy tax withholding obligations associated with the vesting of restricted shares.

ITEM 6. EXHIBITS

| Exhibit<br>Number   | Description of Documents  |
|---------------------|---|
| 3.1                 | Restated Certificate of Incorporation of the Company is incorporated herein by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2009.   |
| 3.2                 | Certificate of Amendment of Restated Certificate of Incorporation of the Company.   |
| 3.3                 | Restated By-Laws of the Company are incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 28, 2012.   |
| 11                  | Statement re: Computation of Per Share Earnings - The computation of basic and diluted earnings per common share is included in Note 7 of the Company's Notes to the Condensed Consolidated Financial Statements included in "ITEM 1. FINANCIAL STATEMENTS" of this document. |
| 15                  | Acknowledgment of Independent Registered Public Accounting Firm.  |
| 31.1                | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2                | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1 <sup>(1)</sup> | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2 <sup>(1)</sup> | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 99                  | Report of Independent Registered Public Accounting Firm.  |
| 101                 | Interactive Data File.  |

<sup>(1)</sup> Furnished, not filed.

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SIGNATURES

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

First Midwest Bancorp, Inc.

/s/ PAUL F. CLEMENS

Paul F. Clemens

Executive Vice President and Chief Financial Officer\*

Date: August 4, 2014

\* Duly authorized to sign on behalf of the registrant.

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