

WINTRUST FINANCIAL CORP

Form 10-Q

August 08, 2018

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

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FORM 10-Q

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

For the quarterly period ended June 30, 2018

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 001-35077

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WINTRUST FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Illinois 36-3873352

(State of incorporation or organization) (I.R.S. Employer Identification No.)

9700 W. Higgins Road, Suite 800

Rosemont, Illinois 60018

(Address of principal executive offices)

(847) 939-9000

(Registrant's telephone number, including area code)

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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 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

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

Emerging growth company

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

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock — no par value, 56,364,762 shares, as of July 31, 2018

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## PART I

## ITEM 1. FINANCIAL STATEMENTS

## WINTRUST FINANCIAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CONDITION

(In thousands, except share data)	(Unaudited) June 30, 2018	December 31, 2017	(Unaudited) June 30, 2017
Assets			
Cash and due from banks	\$ 304,580	\$ 277,534	\$ 296,105
Federal funds sold and securities purchased under resale agreements	62	57	56
Interest bearing deposits with banks	1,221,407	1,063,242	1,011,635
Available-for-sale securities, at fair value	1,940,787	1,803,666	1,649,636
Held-to-maturity securities, at amortized cost (\$851.8 million, \$812.5 million and \$787.5 million fair value at June 30, 2018, December 31, 2017 and June 30, 2017 respectively)	890,834	826,449	793,376
Trading account securities	862	995	1,987
Equity securities with readily determinable fair value	37,839	—	—
Federal Home Loan Bank and Federal Reserve Bank stock	96,699	89,989	80,812
Brokerage customer receivables	16,649	26,431	23,281
Mortgage loans held-for-sale, at fair value	455,712	313,592	382,837
Loans, net of unearned income, excluding covered loans	22,610,560	21,640,797	20,743,332
Covered loans	—	—	50,119
Total loans	22,610,560	21,640,797	20,793,451
Allowance for loan losses	(143,402 )	(137,905 )	(129,591 )
Allowance for covered loan losses	—	—	(1,074 )
Net loans	22,467,158	21,502,892	20,662,786
Premises and equipment, net	639,345	621,895	605,211
Lease investments, net	194,160	212,335	191,248
Accrued interest receivable and other assets	666,673	567,374	577,359
Trade date securities receivable	450	90,014	133,130
Goodwill	509,957	501,884	500,260
Other intangible assets	21,414	17,621	19,546
Total assets	\$ 29,464,588	\$ 27,915,970	\$ 26,929,265
Liabilities and Shareholders' Equity			
Deposits:			
Non-interest bearing	\$ 6,520,724	\$ 6,792,497	\$ 6,294,052
Interest bearing	17,844,755	16,390,850	16,311,640
Total deposits	24,365,479	23,183,347	22,605,692
Federal Home Loan Bank advances	667,000	559,663	318,270
Other borrowings	255,701	266,123	277,710
Subordinated notes	139,148	139,088	139,029
Junior subordinated debentures	253,566	253,566	253,566
Trade date securities payable	—	—	5,151
Accrued interest payable and other liabilities	676,823	537,244	490,389
Total liabilities	26,357,717	24,939,031	24,089,807
Shareholders' Equity:			
Preferred stock, no par value; 20,000,000 shares authorized:			
Series D - \$25 liquidation value; 5,000,000 shares issued and outstanding at June 30, 2018, December 31, 2017 and June 30, 2017	125,000	125,000	125,000

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Common stock, no par value; \$1.00 stated value; 100,000,000 shares authorized at June 30, 2018, December 31, 2017 and June 30, 2017; 56,436,564 shares issued at June 30, 2018, 56,068,220 shares issued at December 31, 2017 and 55,801,665 shares issued at June 30, 2017	56,437	56,068	55,802
Surplus	1,547,511	1,529,035	1,511,080
Treasury stock, at cost, 107,288 shares at June 30, 2018, 103,013 shares at December 31, 2017, and 101,738 shares at June 30, 2017	(5,355	) (4,986	) (4,884
Retained earnings	1,464,494	1,313,657	1,198,997
Accumulated other comprehensive loss	(81,216	) (41,835	) (46,537
Total shareholders' equity	3,106,871	2,976,939	2,839,458
Total liabilities and shareholders' equity	\$29,464,588	\$27,915,970	\$26,929,265

See accompanying notes to unaudited consolidated financial statements.

Table of ContentsWINTRUST FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In thousands, except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Interest income				
Interest and fees on loans	\$255,063	\$209,289	\$490,057	\$406,205
Mortgage loans held-for-sale	4,226	3,420	7,044	5,818
Interest bearing deposits with banks	3,243	1,634	6,039	3,257
Federal funds sold and securities purchased under resale agreements	1	1	1	2
Investment securities	19,888	15,524	39,016	29,097
Trading account securities	4	4	18	15
Federal Home Loan Bank and Federal Reserve Bank stock	1,455	1,153	2,753	2,223
Brokerage customer receivables	167	156	324	323
Total interest income	284,047	231,181	545,252	446,940
Interest expense				
Interest on deposits	35,293	18,471	61,842	34,741
Interest on Federal Home Loan Bank advances	4,263	2,933	7,902	4,523
Interest on other borrowings	1,698	1,149	3,397	2,288
Interest on subordinated notes	1,787	1,786	3,560	3,558
Interest on junior subordinated debentures	2,836	2,433	5,299	4,841
Total interest expense	45,877	26,772	82,000	49,951
Net interest income	238,170	204,409	463,252	396,989
Provision for credit losses	5,043	8,891	13,389	14,100
Net interest income after provision for credit losses	233,127	195,518	449,863	382,889
Non-interest income				
Wealth management	22,617	19,905	45,603	40,053
Mortgage banking	39,834	35,939	70,794	57,877
Service charges on deposit accounts	9,151	8,696	18,008	16,961
Gains (losses) on investment securities, net	12	47	(339)	(8)
Fees from covered call options	669	890	2,266	1,649
Trading gains (losses), net	124	(420)	227	(740)
Operating lease income, net	8,746	6,805	18,437	12,587
Other	14,080	18,110	25,916	30,358
Total non-interest income	95,233	89,972	180,912	158,737
Non-interest expense				
Salaries and employee benefits	121,675	106,502	234,111	205,818
Equipment	10,527	9,909	20,599	18,911
Operating lease equipment depreciation	6,940	5,662	13,473	10,298
Occupancy, net	13,663	12,586	27,430	25,687
Data processing	8,752	7,804	17,245	15,729
Advertising and marketing	11,782	8,726	20,606	13,876
Professional fees	6,484	7,510	13,133	12,170
Amortization of other intangible assets	997	1,141	2,001	2,305
FDIC insurance	4,598	3,874	8,960	8,030
OREO expense, net	980	739	3,906	2,404
Other	20,371	19,091	39,654	36,434
Total non-interest expense	206,769	183,544	401,118	351,662
Income before taxes	121,591	101,946	229,657	189,964

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Income tax expense	32,011	37,049	58,096	66,689
Net income	\$89,580	\$64,897	\$171,561	\$123,275
Preferred stock dividends	2,050	2,050	4,100	5,678
Net income applicable to common shares	\$87,530	\$62,847	\$167,461	\$117,597
Net income per common share—Basic	\$1.55	\$1.15	\$2.98	\$2.20
Net income per common share—Diluted	\$1.53	\$1.11	\$2.93	\$2.11
Cash dividends declared per common share	\$0.19	\$0.14	\$0.38	\$0.28
Weighted average common shares outstanding	56,299	54,775	56,218	53,528
Dilutive potential common shares	928	1,812	909	2,981
Average common shares and dilutive common shares	57,227	56,587	57,127	56,509

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In thousands)	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net income	\$89,580	\$64,897	\$171,561	\$123,275
Unrealized (losses) gains on available-for-sale securities				
Before tax	(9,455 )	17,593	(45,639 )	24,972
Tax effect	2,541	(6,910 )	12,251	(9,810 )
Net of tax	(6,914 )	10,683	(33,388 )	15,162
Reclassification of net gains (losses) on available-for-sale securities included in net income				
Before tax	(20 )	47	(995 )	(8 )
Tax effect	8	(18 )	270	3
Net of tax	(12 )	29	(725 )	(5 )
Reclassification of amortization of unrealized gains and losses on investment securities transferred to held-to-maturity from available-for-sale				
Before tax	20	22	16	1,450
Tax effect	(5 )	(9 )	(4 )	(570 )
Net of tax	15	13	12	880
Net unrealized (losses) gains on available-for-sale securities	(6,917 )	10,641	(32,675 )	14,287
Unrealized gains (losses) on derivative instruments				
Before tax	1,082	(310 )	4,157	1,305
Tax effect	(290 )	123	(1,116 )	(511 )
Net unrealized gains (losses) on derivative instruments	792	(187 )	3,041	794
Foreign currency adjustment				
Before tax	(2,660 )	3,820	(6,513 )	5,035
Tax effect	664	(987 )	1,620	(1,325 )
Net foreign currency adjustment	(1,996 )	2,833	(4,893 )	3,710
Total other comprehensive (loss) income	(8,121 )	13,287	(34,527 )	18,791
Comprehensive income	\$81,459	\$78,184	\$137,034	\$142,066
See accompanying notes to unaudited consolidated financial statements.				



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CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

(In thousands)	Preferred stock	Common stock	Surplus	Treasury stock	Retained earnings	Accumulated other comprehensive loss	Total shareholders' equity
Balance at January 1, 2017	\$251,257	\$51,978	\$1,365,781	\$(4,589)	\$1,096,518	\$ (65,328 )	\$2,695,617
Net income	—	—	—	—	123,275	—	123,275
Other comprehensive income, net of tax	—	—	—	—	—	18,791	18,791
Cash dividends declared on common stock	—	—	—	—	(15,118 )	—	(15,118 )
Dividends on preferred stock	—	—	—	—	(5,678 )	—	(5,678 )
Stock-based compensation	—	—	5,746	—	—	—	5,746
Conversion of Series C preferred stock to common stock	(126,257 )	3,121	123,136	—	—	—	—
Common stock issued for:							
Exercise of stock options and warrants	—	573	14,488	—	—	—	15,061
Restricted stock awards	—	79	(79 )	(295 )	—	—	(295 )
Employee stock purchase plan	—	19	1,230	—	—	—	1,249
Director compensation plan	—	32	778	—	—	—	810
Balance at June 30, 2017	\$125,000	\$55,802	\$1,511,080	\$(4,884)	\$1,198,997	\$ (46,537 )	\$2,839,458
Balance at January 1, 2018	\$125,000	\$56,068	\$1,529,035	\$(4,986)	\$1,313,657	\$ (41,835 )	\$2,976,939
Cumulative effect adjustment from the adoption of:							
Accounting Standards Update ("ASU") 2016-01	—	—	—	—	1,880	(1,880 )	—
ASU 2017-12	—	—	—	—	(116 )	—	(116 )
ASU 2018-02	—	—	—	—	2,974	(2,974 )	—
Net income	—	—	—	—	171,561	—	171,561
Other comprehensive loss, net of tax	—	—	—	—	—	(34,527 )	(34,527 )
Cash dividends declared on common stock	—	—	—	—	(21,362 )	—	(21,362 )
Dividends on preferred stock	—	—	—	—	(4,100 )	—	(4,100 )
Stock-based compensation	—	—	7,098	—	—	—	7,098
Common stock issued for:							
Exercise of stock options and warrants	—	243	9,416	—	—	—	9,659
Restricted stock awards	—	92	(92 )	(369 )	—	—	(369 )
Employee stock purchase plan	—	15	1,223	—	—	—	1,238
Director compensation plan	—	19	831	—	—	—	850
Balance at June 30, 2018	\$125,000	\$56,437	\$1,547,511	\$(5,355)	\$1,464,494	\$ (81,216 )	\$3,106,871

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Six Months Ended	
	June 30, 2018	June 30, 2017
Operating Activities:		
Net income	\$ 171,561	\$ 123,275
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for credit losses	13,389	14,100
Depreciation, amortization and accretion, net	31,986	29,958
Stock-based compensation expense	7,098	5,746
Net amortization of premium on securities	4,069	3,198
Accretion of discount on loans	(9,860 )	(11,979 )
Mortgage servicing rights fair value change, net	(3,664 )	(1,265 )
Originations and purchases of mortgage loans held-for-sale	(1,875,225 )	(1,856,725 )
Proceeds from sales of mortgage loans held-for-sale	1,770,257	1,928,870
Bank owned life insurance ("BOLI") income	(2,258 )	(1,873 )
Decrease in trading securities, net	133	2
Net decrease in brokerage customer receivables	9,782	1,900
Gains on mortgage loans sold	(49,200 )	(43,547 )
Losses on investment securities, net	339	8
Losses (gains) on sales of premises and equipment, net	18	(140 )
Net losses on sales and fair value adjustments of other real estate owned	3,008	896
Increase in accrued interest receivable and other assets, net	(61,083 )	(45,232 )
Increase (decrease) in accrued interest payable and other liabilities, net	92,374	(21,393 )
Net Cash Provided by Operating Activities	102,724	125,799
Investing Activities:		
Proceeds from maturities and calls of available-for-sale securities	133,209	143,983
Proceeds from maturities and calls of held-to-maturity securities	6,014	101,547
Proceeds from sales of available-for-sale securities	208,991	3,676
Proceeds from sales and capital distributions of equity securities without readily determinable fair value	616	—
Purchases of available-for-sale securities	(475,998 )	(184,659 )
Purchases of held-to-maturity securities	(70,993 )	(256,094 )
Purchases of equity securities without readily determinable fair value	(2,741 )	—
(Purchase) redemption of Federal Home Loan Bank and Federal Reserve Bank stock, net	(6,710 )	52,682
Net cash paid in business combinations	(18,708 )	(284 )
Proceeds from sales of other real estate owned	8,236	8,601
Proceeds received from the FDIC related to reimbursements on covered assets	—	791
Net increase in interest bearing deposits with banks	(160,456 )	(31,178 )
Net increase in loans	(937,503 )	(1,032,772 )
Redemption of BOLI	2,121	—
Purchases of premises and equipment, net	(32,318 )	(26,260 )
Net Cash Used for Investing Activities	(1,346,240 )	(1,219,967 )
Financing Activities:		
Increase in deposit accounts	1,182,140	947,150
(Decrease) increase in subordinated notes and other borrowings, net	(4,489 )	15,163
Increase in Federal Home Loan Bank advances, net	107,000	163,000

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Cash payments to settle contingent consideration liabilities recognized in business combinations	—	(1,058 )
Issuance of common shares resulting from the exercise of stock options, employee stock purchase plan and conversion of common stock warrants	11,747	17,120
Common stock repurchases for tax withholdings related to stock-based compensation	(369 )	(295 )
Dividends paid	(25,462 )	(20,796 )
Net Cash Provided by Financing Activities	1,270,567	1,120,284
Net Decrease in Cash and Cash Equivalents	27,051	26,116
Cash and Cash Equivalents at Beginning of Period	277,591	270,045
Cash and Cash Equivalents at End of Period	\$ 304,642	\$ 296,161

See accompanying notes to unaudited consolidated financial statements.

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WINTRUST FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The consolidated financial statements of Wintrust Financial Corporation and Subsidiaries (“Wintrust” or the “Company”) presented herein are unaudited, but in the opinion of management reflect all necessary adjustments of a normal or recurring nature for a fair presentation of results as of the dates and for the periods covered by the consolidated financial statements.

The accompanying consolidated financial statements are unaudited and do not include information or footnotes necessary for a complete presentation of financial condition, results of operations or cash flows in accordance with U.S. generally accepted accounting principles (“GAAP”). The unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”). Operating results reported for the period are not necessarily indicative of the results which may be expected for the entire year. Reclassifications of certain prior period amounts have been made to conform to the current period presentation.

The preparation of the financial statements requires management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities. Management believes that the estimates made are reasonable, however, changes in estimates may be required if economic or other conditions develop differently from management’s expectations. Certain policies and accounting principles inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions, and where changes in those estimates and assumptions could have a significant impact on the financial statements. Management currently views the determination of the allowance for loan losses, allowance for covered loan losses and the allowance for losses on lending-related commitments, loans acquired with evidence of credit quality deterioration since origination, estimations of fair value, the valuations required for impairment testing of goodwill, the valuation and accounting for derivative instruments and income taxes as the accounting areas that require the most subjective and complex judgments, and as such could be the most subject to revision as new information becomes available. Descriptions of the Company’s significant accounting policies are included in Note 1 - “Summary of Significant Accounting Policies” of the 2017 Form 10-K.

(2) Recent Accounting Developments

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-09, which created “Revenue from Contracts with Customers (Topic 606),” to clarify the principles for recognizing revenue and develop a common revenue standard for customer contracts. This ASU provides guidance regarding how an entity should 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 ASU also added a new subtopic to the codification, ASC 340-40, “Other Assets and Deferred Costs: Contracts with Customers” to provide guidance on costs related to obtaining and fulfilling a customer contract. Furthermore, the new standard requires disclosure of sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. At the time ASU No. 2014-09 was issued, the guidance was effective for fiscal years beginning after December 15, 2016. In July 2015, the FASB approved a deferral of the effective date by one year, which resulted in the guidance becoming effective for the Company as of

January 1, 2018.

The FASB continued to issue various updates to clarify and improve specific areas of ASU No. 2014-09. In March 2016, the FASB issued ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," to clarify the implementation guidance within ASU No. 2014-09 surrounding principal versus agent considerations and its impact on revenue recognition. In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," to also clarify the implementation guidance within ASU No. 2014-09 related to these two topics. In May 2016, the FASB issued ASU No. 2016-11, "Revenue Recognition (Topic 605) and Derivative and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting," to remove certain areas of SEC Staff Guidance from those specific Topics. In May 2016 and December 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" and ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers," to clarify specific aspects of implementation, including the collectability criterion, exclusion of sales taxes collected from a transaction price, noncash

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consideration, contract modifications, completed contracts at transition, the applicability of loan guarantee fees, impairment of capitalized contract costs and certain disclosure requirements. In February 2017, the FASB issued ASU No. 2017-05, "Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets," to clarify the implementation guidance within ASU No. 2014-09 surrounding transfers of nonfinancial assets, including partial sales of such assets, and its impact on revenue recognition. Like ASU No. 2014-09, this guidance became effective for the Company starting January 1, 2018.

The Company adopted ASU No. 2014-09 and all subsequent updates issued to clarify and improve specific areas of this ASU as of January 1, 2018. As certain significant revenue sources related to financial instruments such as interest income are considered not in-scope, the new guidance did not have a significant impact on the Company's consolidated financial statements. Revenue sources impacted by the new guidance include brokerage and trust and asset management fees from the wealth management business unit, card-based fees, deposit-related fees and other non-interest income. During implementation, the Company reviewed specific contracts with customers across these various sources of revenue. Reviews of such contracts assisted in identifying any characteristics of such contracts that could result in a change in the Company's current practices for recognition of revenue and recognition of costs incurred to obtain or fulfill such contracts. After review of such contracts, the Company identified no indication within the terms of such contracts that a significant change in the Company's current practices and accounting policies was necessary. The Company elected to adopt the new guidance using the modified retrospective approach applied to all contracts as of the date of initial application at January 1, 2018. Electing the modified retrospective approach resulted in no cumulative effect adjustment to the opening balance of retained earnings at the date of initial application. Additional disclosures have been added in accordance with the new guidance. See Note 13 – Revenue from Contracts with Customers for discussion of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

## Financial Instruments

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," to improve the accounting for financial instruments. This ASU requires equity securities with readily determinable fair values to be measured at fair value with changes recognized in net income. Such equity securities with readily determinable fair values are no longer classified as available-for-sale securities or trading securities within the consolidated financial statements of an entity. For equity securities without a readily determinable fair value, the value of the equity securities may be elected to be measured at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer instead of fair value, unless a qualitative assessment indicates impairment. Additionally, this ASU requires the separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements.

The Company adopted this guidance as of January 1, 2018. For equity securities with a readily determinable fair value, this guidance was applied under a modified retrospective approach with a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. As of January 1, 2018, the Company reclassified approximately \$1.9 million from accumulated other comprehensive income, related to previously recognized unrealized gains, net of deferred taxes, from equity securities with readily determinable fair values, to retained earnings. Equity securities with readily determinable fair values are now prospectively presented separate from available-for-sale securities and trading securities within the Company's Consolidated Statements of Condition. Additionally, for the six months ended June 30, 2018, the Company recognized \$1.0 million of unrealized gains from equity securities with readily determinable fair values directly to earnings. For equity securities without a readily determinable fair value, the Company elected to measure such investments at cost minus impairment, if any, plus or

minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer, unless a qualitative assessment indicates impairment, which was applied prospectively. Equity securities without readily determinable fair values are included within accrued interest receivable and other assets within the Company's Consolidated Statements of Condition. See Note 5 - Investment Securities for further discussion of equity securities with and without readily determinable fair values.

In January 2018, the FASB issued ASU No. 2018-03, "Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," to clarify certain aspects of the guidance issued in ASU No. 2016-01, including aspects of equity securities without a readily determinable fair value. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years beginning after June 15, 2018. Early adoption is permitted. As these clarifications did not have a material impact on the Company's consolidated financial statements, the Company elected to early adopt this guidance as of January 1, 2018.

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### Leases

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," to improve transparency and comparability across entities regarding leasing arrangements. This ASU requires the recognition of a separate lease liability representing the required discounted lease payments over the lease term and a separate lease asset representing the right to use the underlying asset during the same lease term. Further, this ASU provides clarification regarding the identification of certain components of contracts that would represent a lease as well as requires additional disclosures to the notes of the financial statements. Additionally, in January 2018, the FASB issued ASU No. 2018-01, "Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842," to permit an entity to elect an optional practical expedient to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under existing accounting guidance. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and is to be applied under a modified retrospective approach, including the option to apply certain practical expedients.

The FASB has continued to issue various updates to clarify and improve specific areas of ASU No. 2016-02. In July 2018, the FASB issued ASU No. 2018-10, "Codification Improvements to Topic 842, Leases," to clarify the implementation guidance within ASU No. 2016-02 surrounding narrow aspects of Topic 842, including lessee reassessment of lease classifications, the rate implicit in a lease, lessor reassessment of lease terms and purchase options and variable lease payments that depend on an index or a rate. Also, in July 2018, the FASB issued ASU No. 2018-11, "Leases (Topic 842): Targeted Improvements," to clarify the implementation guidance within ASU No. 2016-02 surrounding comparative period reporting requirements for initial adoption as well as separating lease and non-lease components in a contract and allocating consideration in the contract to the separate components. Like ASU No. 2016-02, this guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and is to be applied under a modified retrospective approach.

The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements. Excluding any impact from the clarification of contracts representing a lease, the Company expects to recognize separate lease liabilities and right to use assets for the amounts related to certain facilities under operating lease agreements disclosed in Note 15 - Minimum Lease Commitments in the 2017 Form 10-K. Additionally, the Company does not expect to significantly change operating lease agreements prior to adoption. The Company has established a committee consisting of individuals from various areas of the Company tasked with transitioning the Company to the new guidance requirements. The Company has obtained and reviewed lease agreements related to certain assets as well as other agreements with components representing a lease across its various business units to determine the impact of adoption on the Company's consolidated financial statements.

### Derivatives

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities," to improve the financial reporting of hedging relationships to better align the economic results of an entity's risk management activities and disclosures within its financial statements. In addition, this ASU makes certain targeted improvements to simplify the application of the hedge accounting, including to derivative instruments as well as allow a one-time election to reclassify fixed-rate, prepayable debt securities from a held-to-maturity classification to an available-for-sale classification. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Guidance related to existing cash flow hedges and, if elected, fair value hedges is to be applied under a modified retrospective approach and guidance related to amended presentation and disclosures is to be applied under a prospective approach.



Early adoption is permitted as of the beginning of an annual period that has not been issued or made available for issuance. The Company elected to early adopt this guidance as of January 1, 2018. See Note 15 - Derivative Financial Instruments for further discussion of early adoption of this guidance. The impact of early adoption on the financial statements included the following:

As allowed under the guidance, for certain existing derivative instruments designated as fair value hedges, the Company transitioned the measurement methodology for the related hedged item (loans) to be in accordance with the guidance without dedesignation of the hedging relationship. This resulted in a negative cumulative basis adjustment to loans of \$116,000 with a corresponding adjustment to retained earnings.

No fixed-rate, prepayable held-to-maturity securities were transferred to an available-for-sale classification.

The entire change in the hedging instrument included in the assessment of hedge effectiveness of fair value hedges is presented in the same income statement line as the current impact of the effective portion of such hedge, or interest income and interest expense for interest rate hedging. The Company has previously recognized this ineffectiveness within non-interest income. For the first six months of 2018, the Company recognized \$30,000 of such change in interest income.

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### Allowance for Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” to replace the current incurred loss methodology for recognizing credit losses, which delays recognition until it is probable a loss has been incurred, with a methodology that reflects an estimate of all expected credit losses and considers additional reasonable and supportable forecasted information when determining credit loss estimates. This impacts the calculation of an allowance for credit losses for all financial assets measured under the amortized cost basis, including held-to-maturity debt securities and PCI loans at the time of and subsequent to acquisition. Additionally, credit losses related to available-for-sale debt securities would be recorded through the allowance for credit losses and not as a direct adjustment to the amortized cost of the securities. This guidance is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, and is to be applied under a modified retrospective approach.

The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements as well as the impact on current systems and processes. Specifically, the Company has established a committee consisting of individuals from the various areas of the Company tasked with transitioning to the new requirements. At this time, the Company is reviewing potential accounting policy elections and potential methodologies for estimating expected credit losses using reasonable and supportable forecast information, and has identified certain historical data and system requirements and has reviewed options for platforms to build, store, execute and determine the financial impact.

### Statement of Cash Flows

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force),” to clarify the presentation of specific types of cash flow receipts and payments, including the payment of debt prepayment or debt extinguishment costs, contingent consideration cash payments paid subsequent to the acquisition date and proceeds from settlement of BOLI policies. This guidance became effective as of January 1, 2018 and was applied under a retrospective approach resulting in additional disclosure, including cash payments made to settle contingent consideration liabilities recognized in prior business combinations.

In November 2016, the FASB issued ASU No. 2016-18 “Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force),” to clarify the classification and presentation of changes in restricted cash on the statement of cash flows. This guidance became effective as of January 1, 2018 and did not have a material impact on the Company.

### Income Taxes

In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory,” to improve the accounting for intra-entity transfers of assets other than inventory. This ASU allows the recognition of current and deferred income taxes for such transfers prior to the subsequent sale of the transferred assets to an outside party. Initial recognition of current and deferred income taxes is currently prohibited for intra-entity transfers of assets other than inventory. This guidance became effective as of January 1, 2018 and did not have a material impact on the Company.

The Tax Cuts and Jobs Act (the “Tax Act”) was enacted on December 22, 2017, and the Company recognized a provisional tax benefit of \$7.6 million in 2017 to reflect the impact of the Tax Act, primarily reflecting estimated effects of a lower federal income tax rate on its net deferred tax liabilities and a transition tax due on the deferred earnings of the Company's Canadian subsidiary. Estimates were made in good faith and may change as additional

information and interpretive guidance regarding provisions of the Tax Act become available. Staff Accounting Bulletin 118 provides a measurement period, not to extend beyond one year from the date of enactment, during which a company may complete the accounting for the impacts of the Tax Act. No adjustments were made to the provisional amounts in the first six months of 2018 and the Company expects to complete the accounting for the impacts of the Tax Act in the fourth quarter of 2018.

#### Business Combinations

In January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business," to improve such definition and, as a result, assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or as business combinations. The definition of a business impacts many areas of accounting including acquisitions, disposals, goodwill and consolidation. This guidance became effective as of January 1, 2018 and was applied under a prospective approach. See Note 3 - Business Combinations for further discussion of business combinations including the acquisition of certain assets and assumption of certain liabilities of the mortgage banking business of iFreedom Direct Corporation DBA Veterans First Mortgage ("Veterans First") during the current period.

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### Goodwill

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” to simplify the subsequent measurement of goodwill. When the carrying amount of a reporting unit exceeds its fair value, an entity would no longer be required to determine goodwill impairment by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit was acquired in a business combination. Goodwill impairment would be recognized according to the excess of the carrying amount of the reporting unit over the calculated fair value of such unit. This guidance is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, and is to be applied under a prospective approach. The Company does not expect this guidance to have a material impact on the Company's consolidated financial statements.

### Compensation

In March 2017, the FASB issued ASU No. 2017-07, “Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,” to improve the presentation of net periodic pension cost and net periodic post-retirement benefit cost. An entity will be required to report the service cost component of such costs in the same line item or items as other compensation costs related to services rendered. Additionally, only the service cost component will be eligible for capitalization when applicable. This guidance became effective as of January 1, 2018 and was applied under a retrospective approach related to presentation of the service cost component and a prospective approach related to capitalization of such costs. Adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting,” to clarify when modification accounting is appropriate for changes to the terms and conditions of a share-based payment award. An entity will be required to account for such changes as a modification unless certain criteria is met. This guidance became effective as of January 1, 2018 and was applied under a prospective approach for awards modified on or after the adoption date. Adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

### Amortization of Premium on Certain Debt Securities

In March 2017, the FASB issued ASU No. 2017-08, “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities,” to amend the amortization period for certain purchased callable debt securities held at a premium. The amortization period for such securities will be shortened to the earliest call date. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and is to be applied under a modified retrospective approach. Early adoption is permitted as of the beginning of an annual period that has not been issued or made available for issuance. The Company did not early adopt this guidance as of January 1, 2018. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

### Accumulated Other Comprehensive Income (Loss)

In February 2018, the FASB issued ASU No. 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,” to allow a reclassification from accumulated other comprehensive income to retained earnings related to the stranded tax effects within other comprehensive income resulting from the Federal income tax rate reduction in the Tax Act. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and is to be applied either in the period of adoption or retrospectively to each period or periods in which the

effect of the Tax Act is recognized.

Early adoption is permitted as of the beginning of an annual period that has not been issued or made available for issuance. The Company elected to early adopt this guidance as of January 1, 2018 and applied such reclassification in the current period (period of adoption). As of January 1, 2018, the Company reclassified a stranded credit of \$3.0 million from accumulated other comprehensive income to retained earnings. The Company has a policy for releasing the income tax effects from accumulated other comprehensive income using an individual security approach.

### (3) Business Combinations

#### FDIC-Assisted Transactions

From 2010 to 2012, the Company acquired the banking operations, including the acquisition of certain assets and the assumption of liabilities, of nine financial institutions in FDIC-assisted transactions. Loans comprised the majority of the assets acquired in nearly all of these FDIC-assisted transactions, of which eight such transactions were subject to loss sharing agreements with the

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FDIC whereby the FDIC agreed to reimburse the Company for 80% of losses incurred on the purchased loans, other real estate owned (“OREO”), and certain other assets. Additionally, clawback provisions within these loss share agreements with the FDIC required the Company to reimburse the FDIC for actual losses on covered assets that were lower than the original loss estimates agreed upon with the FDIC with respect of such assets in the loss share agreements. The Company refers to the loans subject to these loss sharing agreements as “covered loans” and uses the term “covered assets” to refer to covered loans, covered OREO and certain other covered assets during periods subject to such agreements.

As of dates subject to such agreements, the loans covered by the loss share agreements were classified and presented as covered loans and the estimated reimbursable losses were recorded as an FDIC indemnification asset or liability in the Consolidated Statements of Condition. The Company recorded the acquired assets and liabilities at their estimated fair values at the acquisition date. The fair value for loans reflected expected credit losses at the acquisition date. Therefore, the Company only recognized a provision for credit losses and charge-offs on the acquired loans for any further credit deterioration subsequent to the acquisition date. See Note 7 — Allowance for Loan Losses, Allowance for Losses on Lending-Related Commitments and Impaired Loans for further discussion of the allowance on covered loans.

The loss share agreements with the FDIC covered realized losses on loans, foreclosed real estate and certain other assets and required the Company to record loss share assets and liabilities that were measured separately from the loan portfolios because they were not contractually embedded in the loans and were not transferable with the loans had the Company chosen to dispose of them. Fair values at the acquisition dates were estimated based on projected cash flows available for loss share based on the credit adjustments estimated for each loan pool and the loss share percentages. The loss share assets and liabilities were recorded as FDIC indemnification assets and other liabilities, respectively, on the Consolidated Statements of Condition as of dates covered by loss share agreements. Subsequent to the acquisition date, reimbursements received from the FDIC for actual incurred losses reduced the FDIC indemnification assets. Reductions to expected losses, to the extent such reductions to expected losses were the result of an improvement to the actual or expected cash flows from the covered assets, also reduced the FDIC indemnification assets and, if necessary, increased any loss share liability when necessary reductions exceeded the current value of the FDIC indemnification assets. In accordance with the clawback provision noted above, the Company was required to reimburse the FDIC when actual losses were less than certain thresholds established for each loss share agreement. The balance of these estimated reimbursements in accordance with clawback provisions and any related amortization were adjusted periodically for changes in the expected losses on covered assets. On the Consolidated Statements of Condition as of dates subject to loss share agreements, estimated reimbursements from clawback provisions were recorded as a reduction to the FDIC indemnification asset or, if necessary, an increase to the loss share liability, which was included within accrued interest payable and other liabilities. In the second quarter of 2017, the Company recorded a \$4.9 million reduction to the estimated loss share liability as a result of an adjustment related to such clawback provisions. Although these assets were contractual receivables from the FDIC and these liabilities were contractual payables to the FDIC, there were no contractual interest rates. Additional expected losses, to the extent such expected losses resulted in recognition of an allowance for covered loan losses, increased the FDIC indemnification asset or reduced the FDIC indemnification liability. The corresponding amortization was recorded as a component of non-interest income on the Consolidated Statements of Income during periods covered by loss share agreements.

The following table summarizes the activity in the Company’s FDIC indemnification liability during the periods covered by loss share agreements indicated below:

	Three	Six
	Months	Months
	Ended	Ended

(Dollars in thousands)

	June 30, 2017	June 30, 2017
Balance at beginning of period	\$18,263	\$16,701
Reductions from reimbursable expenses	(75 )	(157 )
Amortization	455	699
Changes in expected reimbursements to the FDIC for changes in expected credit losses and reimbursable expenses	(3,673 )	(2,659 )
Payments received from the FDIC	405	791
Balance at end of period	\$15,375	\$15,375

On October 16, 2017, the Company entered into agreements with the FDIC that terminate all existing loss share agreements with the FDIC. Under the terms of the agreements, the Company made a net payment of \$15.2 million to the FDIC as consideration for the early termination of the loss share agreements. The Company recorded a pre-tax gain of approximately \$0.4 million in the fourth quarter of 2017 to write off the remaining loss share asset, relieve the claw-back liability and recognize the payment to the FDIC.

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Mortgage Banking Acquisitions

On January 4, 2018, the Company acquired Veterans First with assets including mortgage-servicing-rights on approximately 10,000 loans, totaling an estimated \$1.6 billion in unpaid principal balance. The Company recorded goodwill of \$9.1 million on the acquisition.

On February 14, 2017, the Company acquired certain assets and assumed certain liabilities of the mortgage banking business of American Homestead Mortgage, LLC ("AHM"). The Company recorded goodwill of \$999,000 on the acquisition.

Purchased Credit Impaired ("PCI") Loans

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date. For PCI loans, expected future cash flows at the purchase date in excess of the fair value of loans are recorded as interest income over the life of the loans if the timing and amount of the future cash flows is reasonably estimable ("accretable yield"). The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference and represents probable losses in the portfolio.

In determining the acquisition date fair value of PCI loans, and in subsequent accounting, the Company aggregates these purchased loans into pools of loans by common risk characteristics, such as credit risk rating and loan type. Subsequent to the purchase date, increases in cash flows over those expected at the purchase date are recognized as interest income prospectively. Subsequent decreases to the expected cash flows will result in a provision for loan losses.

The Company purchased a portfolio of life insurance premium finance receivables in 2009. These purchased life insurance premium finance receivables are valued on an individual basis. If credit related conditions deteriorate, an allowance related to these loans will be established as part of the provision for credit losses.

See Note 6—Loans, for additional information on PCI loans.

(4) Cash and Cash Equivalents

For purposes of the Consolidated Statements of Cash Flows, the Company considers cash and cash equivalents to include cash on hand, cash items in the process of collection, non-interest bearing amounts due from correspondent banks, federal funds sold and securities purchased under resale agreements with original maturities of three months or less. These items are included within the Company's Consolidated Statements of Condition as cash and due from banks, and federal funds sold and securities purchased under resale agreements.



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## (5) Investment Securities

The following tables are a summary of the investment securities portfolios as of the dates shown:

	June 30, 2018			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities				
U.S. Treasury	\$ 30,506	\$	—	