FIRST COMMONWEALTH FINANCIAL CORP /PA/
Form 10-K
March 01, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 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 001-11138
FIRST COMMONWEALTH FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1428528
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
601 PHILADELPHIA STREET INDIANA, PA	15701
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: (724) 349-7220
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
COMMON STOCK, $1 PAR VALUE	NEW YORK STOCK EXCHANGE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x
Note—Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.
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 x No ¨
Indicate by check mark whether the registrant has submitted electronically 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 such files). Yes x No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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.
Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨ Emerging growth company ¨
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

The aggregate market value of the voting and non-voting common stock, par value $1 per share, held by non-affiliates of the registrant (based upon the closing sale price on June 30, 2018) was approximately $1,535,578,640.

The number of shares outstanding of the registrant’s common stock, $1.00 Par Value as of February 28, 2019, was 98,641,110.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the annual meeting of shareholders to be held April 23, 2019 are incorporated by reference into Part III.

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FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-K that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified as such. In addition, certain statements may be contained in our future filings with the Securities and Exchange Commission, in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of First Commonwealth or its management or Board of Directors, including those relating to products, services or operations; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believe," "anticipate," "expect," "intend," "plan," "estimate," or words of similar meaning, or future or conditi verbs such as "will," "would," "should," "could" or "may," are intended to identify forward-looking statements. Forward-looki statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- Local, regional, national and international economic conditions and the impact they may have on us and our customers and our assessment of that impact.
- Volatility and disruption in national and international financial and commodity markets.
- Government intervention in the U.S. financial system.
- Changes in the mix of loan geographies, sectors and types or the level of non-performing assets and charge-offs.
- Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
- The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.
- Inflation, interest rate, securities market and monetary fluctuations.
- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which we and our subsidiaries must comply.
- The soundness of other financial institutions.
- Political instability.
- Impairment of our goodwill or other intangible assets.
- Acts of God or of war or terrorism.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by users.
- Changes in consumer spending, borrowings and savings habits.
- Changes in the financial performance and/or condition of our borrowers.
- Technological changes.
- The cost and effects of failure, interruption, or breach of security of our systems.
- Acquisitions and integration of acquired businesses.
- Our ability to attract and retain qualified employees.
- Changes in the competitive environment in our markets and among banking organizations and other financial service providers.
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.
- Changes in the reliability of our vendors, internal control systems or information systems.
- Changes in our liquidity position.

- Changes in our organization, compensation and benefit plans.
- The costs and effects of legal and regulatory developments, the resolution of legal proceedings or regulatory or other governmental inquiries, the results of regulatory examinations or reviews and the ability to obtain required regulatory approvals.
- Greater than expected costs or difficulties related to the integration of new products and lines of business.
- Our success at managing the risks involved in the foregoing items.
- The risk factors described in Item 1A of this Annual Report.

Forward-looking statements speak only as of the date on which such statements are made. We do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

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PART I

ITEM 1. Business

Overview

First Commonwealth Financial Corporation ("First Commonwealth," the "Company" or "we") is a financial holding company headquartered in Indiana, Pennsylvania. We provide a diversified array of consumer and commercial banking services through our bank subsidiary, First Commonwealth Bank ("FCB" or the "Bank"). We also provide trust and wealth management services and offer insurance products through FCB and our other operating subsidiaries. At December 31, 2018, we had total assets of $7.8 billion, total loans of $5.8 billion, total deposits of $5.9 billion and shareholders' equity of $975.4 million. Our principal executive office is located at 601 Philadelphia Street, Indiana, Pennsylvania 15701, and our telephone number is (724) 349-7220.

FCB is a Pennsylvania bank and trust company. At December 31, 2018, the Bank operated 137 community banking offices throughout western and central Pennsylvania, and northeasern, central and southwestern Ohio, as well as corporate banking centers in Pittsburgh, Pennsylvania, and Columbus and Cleveland, Ohio, and mortgage banking offices in Wexford, Pennsylvania, and Hudson and Dublin, Ohio. The Bank also operates a network of 150 automated teller machines, or ATMs, at various branch offices and offsite locations. All of our ATMs are part of the NYCE and MasterCard/Cirrus networks, both of which operate nationwide. The Bank is a member of the Allpoint ATM network, which allows surcharge-free access to over 55,000 ATMs. The Bank is also a member of the "Freedom ATM Alliance," which affords cardholders surcharge-free access to a network of over 670 ATMs in over 50 counties in Pennsylvania, Maryland, New York, and Ohio.

Historical and Recent Developments

FCB began in 1934 as First National Bank of Indiana. First National Bank of Indiana changed its name to National Bank of the Commonwealth in 1971 and became a subsidiary of First Commonwealth in 1983.

Since the formation of the holding company in 1983, we have grown steadily through the acquisition of smaller banks and thrifts in our market area, including Deposit Bank in 1984, Dale National Bank and First National Bank of Leechburg in 1985, Citizens National Bank of Windber in 1986, Peoples Bank and Trust Company in 1990, Central Bank in 1992, Peoples Bank of Western Pennsylvania in 1993, and Unitas National Bank and Reliable Savings Bank in 1994. In 1995, we merged all of our banking subsidiaries (other than Reliable Savings Bank) into Deposit Bank and renamed the resulting institution "First Commonwealth Bank." We then merged Reliable Savings Bank into FCB in 1997. We acquired Southwest Bank in 1998 and merged it into FCB in 2002.

We expanded our presence in the Pittsburgh market through the acquisitions of Pittsburgh Savings Bank (dba BankPittsburgh) in 2003, Great American Federal in 2004 and Laurel Savings Bank in 2006. These acquisitions added 27 branches in Allegheny and Butler Counties.

We have also focused on organic growth, improving the reach of our franchise and the breadth of our product offering. As part of this strategy, we have opened fourteen de novo branches since 2005, all of which are in the greater Pittsburgh area. As a result of our prior acquisitions and de novo strategy, FCB operates 59 branches and a corporate banking center in the Pittsburgh metropolitan statistical area and currently ranks tenth in deposit market share.

In 2015, we expanded into central Ohio through the acquisition of First Community Bank with four branches in the Columbus area. In 2016, we acquired 13 branches from FirstMerit Bank, National Association, in Canton-Massillon and Ashtabula, Ohio and in 2017, we acquired DCB Financial Corp ("DCB") and its banking subsidiary The Delaware County Bank and Trust Company with nine full-service banking offices in the Columbus, Ohio MSA. In 2018, we acquired Garfield Acquisition Corp., and its banking subsidiary Foundation Bank with five full-service banking offices in the Cincinnati, Ohio area. Additionally, since 2014, we have expanded our presence in this Ohio market by opening a corporate loan production office in Columbus and Cleveland, Ohio, and three mortgage loan offices in Hudson, Dublin, and Columbus, Ohio.

Our operating objectives include expansion, diversification within our markets, growth of our fee-based income, and growth internally and through acquisitions of financial institutions, branches, and financial services businesses. We generally seek merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. We regularly evaluate merger and acquisition opportunities and, from time to time, conduct due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations, may take place and future merger acquisitions involving cash, debt or equity securities may occur. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of First Commonwealth’s tangible book value and net income per common share may occur in connection with any future transaction. Our ability to engage in certain merger or acquisition transactions, whether or not any regulatory approval is required, will be dependent upon our bank regulators' views at the time as to the capital levels, quality of management and our overall condition and their assessment of a variety of other factors. Certain merger or acquisition transactions, including those involving the acquisition of a depository institution or the assumption of the deposits of any depository institution, require formal approval from various bank regulatory authorities, which will be subject to a variety of factors and considerations.

Loan Portfolio

The Company's loan portfolio includes several categories of loans that are discussed in detail below.

Commercial, Financial, Agricultural and Other

Commercial, financial, agricultural and other loans represent term loans used to acquire business assets or revolving lines of credit used to finance working capital. These loans are generally secured by a first lien position on the borrower's business assets as a secondary source of repayment. The type and amount of the collateral varies depending on the amount and terms of the loan, but generally may include accounts receivable, inventory, equipment or other assets. Loans also may be supported by personal guarantees from the principals of the commercial loan borrowers.

Commercial loans are underwritten for credit-worthiness based on the borrowers' financial information, cash flow, net worth, prior loan performance, existing debt levels, type of business and the industry in which it operates. Advance rates on commercial loans are generally collateral-dependent and are determined based on the type of equipment, the mix of inventory and the quality of receivables.

Credit risk for commercial loans can arise from a borrower's inability or unwillingness to repay the loan, and in the case of secured loans, from a shortfall in the collateral value in relation to the outstanding loan balance in the event of a default and subsequent liquidation of collateral. The Company's Credit Policy establishes loan concentration limits by borrower, geography and industry.

Commercial Real Estate

Commercial real estate loans represent term loans secured by owner-occupied and non-owner occupied properties. Commercial real estate loans are underwritten based on an evaluation of each borrower's cash flow as the principal source of loan repayment, and are generally secured by a first lien on the property as a secondary source of repayment. Our underwriting process for non-owner occupied properties evaluates the history of occupancy, quality of tenants, lease terms, operating expenses and cash flow. Commercial real estate loans are subject to the same credit evaluation as previously described for commercial loans. Approximately 18%, by principal amount, of our commercial real estate loans involve owner-occupied properties.

For loans secured by commercial real estate, at origination the Company obtains current and independent appraisals from licensed or certified appraisers to assess the value of the underlying collateral. The Company's general policy for commercial real estate loans is to limit the terms of the loans to not more than 10 years with loan-to-value ratios not exceeding 80% on owner-occupied and income producing properties. For non-owner occupied commercial real estate loans, the loan terms are generally aligned with the property's lease terms and are generally underwritten with a loan-to-value ratio not exceeding 75%.

Credit risk for commercial real estate loans can arise from economic conditions that could impact market demand, rental rates and property vacancy rates and declines in the collateral value in relation to the outstanding loan balance in the event of a default and subsequent liquidation of collateral.

Real Estate Construction

Real estate construction represents financing for real estate development. The underwriting process for these loans is designed to confirm that the project will be economically feasible and financially viable and is generally conducted as though the Company would be providing permanent financing for the project. Development and construction loans are secured by the properties under development or construction, and personal guarantees are typically obtained as a secondary repayment source. The Company considers the financial condition and reputation of the borrower and any guarantors and generally requires a global cash flow analysis in order to assess the overall financial position of the developer.

Construction loans to residential builders are generally made for the construction of residential homes for which a binding sales contract exists and for which the prospective buyers have been pre-qualified for permanent mortgage financing by either third-party lenders or the Company. These loans are generally for a period of time sufficient to complete construction.

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Residential construction loans to individuals generally provide for the payment of interest only during the construction phase. At the end of the construction phase, substantially all of our loans automatically convert to permanent mortgage loans and can either be retained in our loan portfolio or sold on the secondary market.

Credit risk for real estate construction loans can arise from construction delays, cost overruns, failure of the contractor to complete the project to specifications and economic conditions that could impact demand for or supply of the property being constructed.

Residential Real Estate Loans

Residential real estate loans include first lien mortgages used by the borrower to purchase or refinance a principal residence and home equity loans and lines of credit secured by residential real estate. The Company’s underwriting process for these loans determines credit-worthiness based upon debt-to-income ratios, collateral values and other relevant factors.

Credit risk for residential real estate loans can arise from a borrower’s inability or unwillingness to repay the loan or a shortfall in the value of the residential real estate in relation to the outstanding loan balance in the event of a default and subsequent liquidation of the real estate collateral.

The residential real estate portfolio includes both conforming and non-conforming mortgage loans. Conforming mortgage loans represent loans originated in accordance with underwriting standards set forth by the government-sponsored entities, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association, which serve as the primary purchasers of loans sold in the secondary mortgage market by mortgage lenders. These loans are generally collateralized by one-to-four-family residential real estate, have loan-to-collateral value ratios of 80% or less (or have mortgage insurance to insure down to 80%), and are made to borrowers in good credit standing. Non-conforming mortgage loans represent loans that generally are not saleable in the secondary market to the government-sponsored entities due to factors such as the credit characteristics of the borrower, the underlying documentation, the loan-to-value ratio, or the size of the loan. The Company does not offer “subprime,” “interest-only” or “negative amortization” mortgages.

Home equity lines of credit and other home equity loans are originated by the Company for typically up to 90% of the appraised value, less the amount of any existing prior liens on the property. Additionally, the Company’s credit policy requires borrower FICO scores of not less than 661 and a debt-to-income ratio of not more than 43%.

Loans to Individuals

The Loans to Individuals category includes consumer installment loans, personal lines of credit, consumer credit cards and indirect automobile loans. Credit risk for consumer loans can arise from a borrower’s inability or unwillingness to repay the loan, and in the case of secured loans, by a shortfall in the value of the collateral in relation to the outstanding loan balance in the event of a default and subsequent liquidation of collateral.

The underwriting criteria for automobile loans generally allows for such loans to be made for up to 100% of the purchase price or the retail value of the vehicle as listed by the National Automobile Dealers Association. The terms of the loan are determined by the age and condition of the collateral, and range from 36 to 84 months. Collision insurance policies are required on all automobile loans. The Company also makes other consumer loans, which may or may not be secured. The terms of secured consumer loans generally depend upon the nature of the underlying collateral. Unsecured consumer loans and consumer credit cards usually do not exceed $35 thousand. Unsecured consumer loans usually have a term of no longer than 36 months.

Deposits

Deposits are our primary source of funds to support our revenue-generating assets. We offer traditional deposit products to businesses and other customers with a variety of rates and terms. Deposits at our bank are insured by the FDIC up to statutory limits. We price our deposit products with a view to maximizing our share of each customer’s financial services business and prudently managing our cost of funds. At December 31, 2018, we held $5.9 billion of total deposits, which consisted of $1.5 billion, or 25%, in non-interest bearing checking accounts, $3.6 billion, or 61%, in interest bearing checking accounts, money market and savings accounts, and $0.9 billion, or 14%, in CDs and IRAs.

Competition

The banking and financial services industry is extremely competitive in our market area. We face vigorous competition for customers, loans and deposits from many companies, including commercial banks, savings and loan associations, finance companies, credit unions, trust companies, mortgage companies, money market mutual funds, insurance companies, and brokerage and investment firms. Many of these competitors are significantly larger than us, have greater resources, higher lending limits and larger branch systems and offer a wider array of financial services than us. In addition, some of these competitors, such as credit unions, are subject to a lesser degree of regulation or taxation than that imposed on us.

Employees

At December 31, 2018, First Commonwealth and its subsidiaries employed 1,363 full-time employees and 149 part-time employees.

Supervision and Regulation

The following discussion sets forth the material elements of the regulatory framework applicable to financial holding companies, such as First Commonwealth, and their subsidiaries. The regulatory framework is intended primarily for the protection of depositors, other customers and the federal deposit insurance fund and not for the protection of security holders. The rules governing the regulation of financial institutions and their holding companies are very detailed and technical. Accordingly, the following discussion is general in nature and is not intended to be complete or to describe all the laws and regulations that apply to First Commonwealth and its subsidiaries. A change in applicable statutes, regulations or regulatory policy may have a material adverse effect on our business, financial condition or results of operations.

Bank Holding Company Regulation

First Commonwealth is registered as a financial holding company under the Bank Holding Company Act of 1956, as amended (“BHC Act”), and is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (“FRB”).

Acquisitions. Under the BHC Act, First Commonwealth is required to obtain the prior approval of the FRB before it can merge or consolidate with any other bank holding company or acquire all or substantially all of the assets of any bank that is not already majority owned by it, or acquire direct or indirect ownership, or control of, any voting shares of any bank that is not already majority owned by it, if after such acquisition it would directly or indirectly own or control more than 5% of the voting shares of such bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the financial, including capital, position of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act ("CRA") and its compliance with fair housing and other consumer protection laws and the effectiveness of the subject organizations in combating money laundering activities.

Non-Banking Activities. In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. In addition, bank holding companies that qualify and elect to be financial holding companies such as First Commonwealth may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity or (ii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally, without in either case the prior approval of the FRB. Activities that are financial in nature include securities underwriting and dealing, insurance agency activities and making merchant banking investments.

To maintain financial holding company status, a financial holding company and all of its depository institution subsidiaries must be well capitalized and well managed. A depository institution subsidiary is considered to be well capitalized if it satisfies the requirements for this status discussed in the section below captioned "Prompt Corrective Action". A depository institution subsidiary is considered well managed if it received a composite rating and management rating of at least satisfactory in its most recent examination. A financial holding company’s status will also depend upon maintaining its status as well capitalized and well managed under applicable FRB regulations. If a financial holding company ceases to meet these capital and management requirements, the FRB’s regulations provide that the financial holding company must enter into an agreement with the FRB to comply with all applicable capital and management requirements. Until the financial holding company returns to compliance, the FRB may impose limitations or conditions on the conduct of its activities, and the company may not commence any of the broader financial activities permissible for financial holding companies or acquire a company engaged in such financial activities without prior approval of the FRB. If the company does not return to compliance within 180 days, the FRB may require divestiture of the holding company's depository institutions.

In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire a company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least satisfactory in its most recent examination under the CRA.

The FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or

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such ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

Reporting. Under the BHC Act, First Commonwealth is subject to examination by the FRB and is required to file periodic reports and other information of its operations with the FRB. In addition, under the Pennsylvania Banking Code of 1965, the Pennsylvania Department of Banking and Securities has the authority to examine the books, records and affairs of any Pennsylvania bank holding company or to require any documentation deemed necessary to ensure compliance with the Pennsylvania Banking Code.

Source of Strength Doctrine. FRB policy has historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") codifies this policy as a statutory requirement. Under this requirement, First Commonwealth is expected to commit resources to support FCB, including at times when First Commonwealth may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Affiliate Transactions. Transactions between FCB, on the one hand, and First Commonwealth and its other subsidiaries, on the other hand, are regulated under federal banking laws. The Federal Reserve Act imposes quantitative and qualitative requirements and collateral requirements on covered transactions by FCB with, or for the benefit of, its affiliates, and generally requires those transactions to be on terms at least as favorable to FCB as if the transaction were conducted with an unaffiliated third party. Covered transactions are defined by statute to include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the FRB) from the affiliate, certain derivative transactions that create a credit exposure to an affiliate, the acceptance of securities issued by the affiliate as collateral for a loan, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. In general, any such transaction by FCB (or its subsidiaries) must be limited to certain thresholds on an individual and aggregate basis and, for credit transactions with any affiliate, must be secured by designated amounts of specified collateral.

SEC Regulations. First Commonwealth is also under the jurisdiction of the Securities and Exchange Commission ("SEC") and various state securities commissions for matters relating to the offer and sale of its securities and is subject to the SEC rules and regulations relating to periodic reporting, proxy solicitation and insider trading.

Bank Regulation

FCB is a state bank chartered under the Pennsylvania Banking Code and is not a member of the FRB. As such, FCB is subject to the supervision of, and is regularly examined by, both the Federal Deposit Insurance Corporation ("FDIC") and the Pennsylvania Department of Banking and Securities and is required to furnish quarterly reports to both agencies. The approval of the Pennsylvania Department of Banking and Securities and FDIC is also required for FCB to establish additional branch offices or merge with or acquire another banking institution.

Dividends. First Commonwealth is a legal entity separate and distinct from its banking and other subsidiaries. As a bank holding company, First Commonwealth is subject to certain restrictions on its ability to pay dividends under applicable banking laws and regulations. Federal bank regulators are authorized to determine under certain circumstances relating to the financial condition of a bank holding company or a bank that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. In particular, federal bank regulators have stated that paying dividends that deplete a banking organization's capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings.

A significant portion of our income comes from dividends from our bank, which is also the primary source of our liquidity. In addition to the restrictions discussed above, our bank is subject to limitations under Pennsylvania law regarding the level of dividends that it may pay to us. In general, dividends may be declared and paid only out of accumulated net earnings and may not be declared or paid unless surplus is at least equal to capital. Dividends may not reduce surplus without the prior consent of the Pennsylvania Department of Banking and Securities. FCB has not reduced its surplus through the payment of dividends. As of December 31, 2018, FCB could pay dividends to First Commonwealth of $259.1 million without reducing its capital levels below "well capitalized" levels and without the approval of the Pennsylvania Department of Banking and Securities.

Community Reinvestment. Under the Community Reinvestment Act ("CRA") a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the applicable regulatory agency to assess an institution’s record of meeting the credit needs of its community. The CRA requires public disclosure of an institution’s CRA rating and requires that the applicable regulatory agency provide a written evaluation of an institution’s CRA performance utilizing a four-tiered descriptive rating system. An institution’s CRA rating is considered in determining whether to grant charters, branches and other deposit facilities, relocations, mergers, consolidations and acquisitions. Performance less than satisfactory may be the basis for denying an application. For its most recent examination, FCB received a “satisfactory” rating. In April 2018, the U.S. Department of Treasury issued a memorandum to the federal banking regulators with recommended changes to the CRA’s implementing regulations to reduce their complexity and associated burden on banks. We will continue to evaluate the impact of any changes to the regulations implementing the CRA.

Consumer Financial Protection. We are subject to a number of federal and state consumer protection laws that extensively govern our relationship with our customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act and these laws’ respective state-law counterparts, as well as state usury laws and laws regarding unfair and deceptive acts and practices. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices, restrict our ability to raise interest rates and subject us to substantial regulatory oversight. Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys’ fees. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce consumer protection requirements and obtain these and other remedies, including regulatory sanctions, customer rescission rights, action by the state and local attorneys general in each jurisdiction in which we operate and civil money penalties. Failure to comply with consumer protection requirements may also result in our failure to obtain any required bank regulatory approval for merger or acquisition transactions we may wish to pursue or our prohibition from engaging in such transactions even if approval is not required.

The Dodd-Frank Act created a new, independent federal agency, the Consumer Financial Protection Bureau ("CFPB"), which was granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. The CFPB is also authorized to engage in consumer financial education, track consumer complaints, request data and promote the availability of financial services to underserved consumers and communities. Although all institutions are subject to rules adopted by the CFPB and examination by the CFPB in conjunction with examinations by the institution’s primary federal regulator, the CFPB has primary examination and enforcement authority over institutions with assets of $10 billion or more. The FDIC has primary responsibility for examination of our bank and enforcement with respect to federal consumer protection laws so long as our bank has total consolidated assets of less than $10 billion, and state authorities are responsible for monitoring our compliance with all state consumer laws. The CFPB also has the authority to require reports from institutions with less than $10 billion in assets, such as our bank, to support the CFPB in implementing federal consumer protection laws, supporting examination activities, and assessing and detecting risks to consumers and financial markets.

The consumer protection provisions of the Dodd-Frank Act and the examination, supervision and enforcement of those laws and implementing regulations by the CFPB have created a more intense and complex environment for consumer finance regulation. The CFPB has significant authority to implement and enforce federal consumer finance laws, including the Truth in Lending Act, the Equal Credit Opportunity Act and new requirements for financial services products provided for in the Dodd-Frank Act, as well as the authority to identify and prohibit unfair, deceptive or abusive acts and practices. The review of products and practices to prevent such acts and practices is a continuing focus of the CFPB, and of banking regulators more broadly. The ultimate impact of this heightened scrutiny is uncertain but could result in changes to pricing, practices, products and procedures. It could also result in increased costs related to regulatory oversight, supervision and examination, additional remediation efforts and possible penalties. In addition, the Dodd-Frank Act provides the CFPB with broad supervisory, examination and enforcement authority over various consumer financial products and services, including the ability to require reimbursements and other payments to customers for alleged legal violations and to impose significant penalties, as well as injunctive relief that prohibits lenders from engaging in allegedly unlawful practices. The CFPB also has the authority to obtain cease and desist orders providing for affirmative relief or monetary penalties. The Dodd-Frank Act does not prevent states from adopting stricter consumer protection standards. State regulation of financial products and potential enforcement actions could also adversely affect our business, financial condition or results of operations.

Deposit Insurance. Deposits of FCB are insured up to applicable limits by the FDIC and are subject to deposit insurance assessments to maintain the Deposit Insurance Fund ("DIF"). Deposit insurance assessments are based upon average total assets minus average total equity. The insurance assessments are based upon a matrix that takes into account a bank's capital level and supervisory rating. The FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. As an institution with less than $10 billion in assets, FCB's assessment rates are based on its risk classification (i.e., the level of risk it poses to the FDIC's deposit insurance fund). For institutions with $10 billion or more in assets, assessment rates are calculated using a scorecard that combines the supervisory risk ratings of the institution with certain forward-looking financial measures. These assessment rates are subject to adjustments based upon the insured depository institution's ratio of long-term unsecured debt to the assessment base, long-term unsecured debt issued by other insured depository institutions to the assessment base, and brokered deposits to the assessment base. However, the adjustments based on brokered deposits to the assessment base will not apply so long as the institution is well capitalized and has a composite CAMELS rating of 1 or 2. The CAMELS rating system is a bank rating system where bank supervisory authorities rate institutions according to six factors: capital adequacy, asset quality, management quality, earnings, liquidity, and sensitivity to market risk. The FDIC may make additional discretionary assessment rate adjustments.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. In August 2016, the FDIC announced that the DIF reserve ratio had surpassed 1.15% as of June 30, 2016. As a result, beginning in the third quarter of 2016, the range of initial assessment ranges for all institutions were adjusted downward such that the initial base deposit insurance assessment rate ranges from 3 to 30 basis points on an annualized basis. After the effect of potential base-rate adjustments, the total base assessment rate could range from 1.5 to 40 basis points on an annualized basis. In March 2016, the FDIC adopted a final rule increasing the reserve ratio for the Deposit Insurance Fund to 1.35% of total insured deposits. The rule imposes a surcharge on the assessments of depository institutions with $10 billion or more in assets beginning the third quarter of 2016 and continuing through the earlier of the quarter that the reserve ratio first reaches or exceeds 1.35% and December 31, 2018. This surcharge does not currently impact FCB.

Repeal Of Federal Prohibitions On Payment Of Interest On Demand Deposits. The federal prohibition restricting depository institutions from paying interest on demand deposit accounts was repealed effective on July 21, 2011 as part of the Dodd-Frank Act.

Capital Requirements

First Commonwealth and FCB are each required to comply with applicable capital adequacy standards established by the FRB. The current risk-based capital standards applicable to First Commonwealth and FCB are based on the December 2010 final capital framework for strengthening international capital standards, known as Basel III, of the Basel Committee on Banking Supervision (the "Basel Committee").

Prior to January 1, 2015, the risk-based capital standards applicable to First Commonwealth and FCB were based on the 1988 Capital Accord, known as Basel I, of the Basel Committee. In July 2013, the federal bank regulators approved final rules (the "Basel III Capital Rules") implementing the Basel III framework as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including First Commonwealth and FCB, as compared to the Basel I risk-based capital rules. The Basel III Capital Rules became effective for First Commonwealth and FCB on January 1, 2015 (subject to a phase-in period for certain provisions).

The Basel III Capital Rules, among other things:

- introduce a new capital measure called Common Equity Tier 1 ("CET1");
- define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital;
- specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements; and
- expand the scope of the deductions/adjustments as compared to existing regulations.

Under the Basel III Capital Rules, the initial minimum capital ratios that became effective on January 1, 2015 are as follows:

- 4.5% CET1 to risk-weighted assets
- 6.0% Tier 1 capital to risk-weighted assets
- 8.0% Total capital to risk-weighted assets
- 4.0% Tier 1 capital to average quarterly assets

Since being fully phased-in on January 1, 2019, the Basel III Capital Rules require First Commonwealth and FCB to maintain a 2.5% "capital conservation buffer" over the required ratios of CET1 to risk-weighted assets, Tier 1 capital to risk-weighted assets and Total capital to risk-weighted assets, effectively resulting in minimum ratios of 7.0%, 8.5% and 10.5%, respectively.

Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. During 2015, First Commonwealth and FCB made a one-time permanent election, as permitted under Basel III Capital Rules, to exclude the effects of accumulated other comprehensive income items for the purposes of determining regulatory capital ratios.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and was phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and was phased-in over a four-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019).

With respect to FCB, the Basel III Capital Rules also revise the "prompt corrective action" regulations pursuant to Section 38 of the Federal Deposit Insurance Act, as discussed below under "Prompt Corrective Action." The Basel III Capital Rules prescribe a standardized approach for risk weightings that expand the risk-weighting categories from the four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. Management believes that, as of December 31, 2018, First Commonwealth and FCB has met all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements had been in effect as of that date.

Liquidity Requirements

Historically, regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III final framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward will be required by regulation. One such test, referred to as the liquidity coverage ratio ("LCR"), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other, referred to as the net stable funding ratio ("NSFR"), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. In September 2014, the federal bank regulators approved final rules implementing the LCR for advanced approaches banking organizations (i.e., banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure) and a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approach banking organizations, neither of which would apply to First Commonwealth or FCB. While not required, FCB nevertheless utilizes a modified version of the LCR as a helpful tool for monitoring its liquidity position. In the second quarter of 2016, the federal banking regulators issued a proposed rule that would implement the NSFR for certain U.S. banking organizations. The proposed rule would require certain U.S. banking organizations to ensure they have access to stable funding over a one-year time horizon and has an effective date of January 1, 2018. The proposed rule would not apply to U.S. banking organizations with less than $50 billion in total consolidated assets such as First Commonwealth or FCB. Following the enactment of the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 ("EGRRCPA"), the Federal Reserve Board stated in July 2018 that it would no longer require bank holding companies with less than $100 billion in total consolidated assets to comply with the modified version of the LCR. In addition, in October 2018, the federal bank regulators proposed to revise their liquidity requirements so that banking organizations that are not global systemically important banks and have less than $250 billion in total consolidated assets and less than $75 billion in each of off-balance-sheet exposure, nonbank assets, cross-jurisdictional activity and short-term wholesale funding would not be subject to any LCR or NSFR requirements.

Prompt Corrective Action

The Federal Deposit Insurance Act, as amended (“FDIA”), requires, among other things, the federal banking agencies to take “prompt corrective action” in respect of depository institutions that do not meet minimum capital requirements. The FDIA includes the following five capital tiers: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” A depository institution’s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures are the total capital ratio, the CET1 capital ratio (a new ratio requirement under the Basel III Capital Rules), the Tier 1 capital ratio and the leverage ratio.

A bank will be (i) “well capitalized” if the institution has a total risk-based capital ratio of 10.0% or greater, a CET1 capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) “adequately capitalized” if the institution has a total risk-based capital ratio of 8.0% or greater, a CET1 capital ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 4.0% or greater and is not “well capitalized”; (iii) “undercapitalized” if the institution has a total risk-based capital ratio that is less than 8.0%, a CET1 capital ratio less than 4.5%, a Tier 1 risk-based capital ratio of less than 6.0% or a leverage ratio of less than 4.0%; (iv) “significantly undercapitalized” if the institution has a total risk-based capital ratio of less than 6.0%, a CET1 capital ratio less than 3%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%; and (v) “critically undercapitalized” if the institution’s tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank’s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank’s overall financial condition or prospects for other purposes.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be “undercapitalized.” “Undercapitalized” institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. In addition, for a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan and must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution’s total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is “significantly undercapitalized.”

In addition, the FDIA prohibits an insured depository institution from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in the bank's normal market area or nationally (depending upon where the deposits are solicited), unless it is well capitalized or is adequately capitalized and receives a waiver from the FDIC. A depository institution that is adequately capitalized and accepts brokered deposits under a waiver from the FDIC may not pay an interest rate on any deposit in excess of 75 basis points over certain prevailing market rates.

“Significantly undercapitalized” depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become “adequately capitalized,” requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. “Critically undercapitalized” institutions are subject to the appointment of a receiver or conservator.

The appropriate federal banking agency may, under certain circumstances, reclassify a well-capitalized insured depository institution as adequately capitalized. The FDIA provides that an institution may be reclassified if the appropriate federal banking agency determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice.

The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

First Commonwealth believes that, as of December 31, 2018, FCB was a “well-capitalized” bank as defined by the FDIA. See Note 26 “Regulatory Restrictions and Capital Adequacy” of Notes to the Consolidated Financial Statements, contained in Item 8, for a table that provides a comparison of First Commonwealth’s and FCB’s risk-based capital ratios

and the leverage ratio to minimum regulatory requirements.
The Volcker Rule
The Dodd-Frank Act prohibits banks and their affiliates from engaging in proprietary trading and investing in and sponsoring hedge funds and private equity funds (so called "covered funds"). The statutory provision is commonly called the “Volcker Rule.” Banks with less than $10 billion in total consolidated assets, such as FCB, that do not engage in any covered activities, other than trading in certain government, agency, state or municipal obligations, do not have any significant compliance obligations under the rules implementing the Volcker Rule.

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Depositor Preference
Under federal law, depositors (including the FDIC with respect to the subrogated claims of insured depositors) and certain claims for administrative expenses of the FDIC as receiver would be afforded a priority over other general unsecured claims against such an institution in the liquidation or other resolution of such an institution by any receiver.
Interchange Fees
Under the Durbin Amendment to the Dodd-Frank Act, the FRB adopted rules establishing standards for assessing whether the interchange fees that may be charged with respect to certain electronic debit transactions are "reasonable and proportional" to the costs incurred by issuers for processing such transactions. Interchange fees, or "swipe" fees, are charges that merchants pay to us and other card-issuing banks for processing electronic payment transactions. Under the final rules, the maximum permissible interchange fee is equal to no more than 21 cents plus 5 basis points of the transaction value for many types of debit interchange transactions. The FRB also adopted a rule to allow a debit card issuer to recover 1 cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements required by the FRB. The FRB also has rules governing routing and exclusivity that require issuers to offer two unaffiliated networks for routing transactions on each debit or prepaid product.
The Dodd-Frank Act contained an exemption from the interchange fee cap for any debit card issuer that, together with its affiliates, has total assets of less than $10 billion as of the end of the previous calendar year. We currently qualify for this exemption. We earned approximately $20.2 million in card related interchange income during the 2018 fiscal year. If we did not qualify for this exemption, we estimate that our interchange income would have been approximately $11.7 million, representing a $8.4 million reduction due to the cap on interchange fees. We would become subject to the interchange fee cap beginning July 1 of the year following the time when our total assets reaches or exceeds $10 billion.

Enhanced Prudential Standards

The Dodd-Frank Act, as amended by EGRRCPA, which was signed into law on May 24, 2018, directs the Federal Reserve Board to monitor emerging risks to financial stability and enact enhanced supervision and prudential standards applicable to bank holding companies with total consolidated assets of $250 billion or more and non-bank covered companies designated as systemically important by the Financial Stability Oversight Council (often referred to as systemically important financial institutions). The Dodd-Frank Act mandates that certain regulatory requirements applicable to systemically important financial institutions be more stringent than those applicable to other financial institutions. In general, EGRRCPA increased the statutory asset threshold above which the Federal Reserve is required to apply these enhanced prudential standards from $50 billion to $250 billion (subject to certain discretion by the Federal Reserve to apply any enhanced prudential standard requirement to any BHC with between $100 billion and $250 billion in total consolidated assets that would otherwise be exempt under EGRRCPA). BHCs with $250 billion or more in total consolidated assets remain fully subject to the Dodd-Frank Act's enhanced prudential standards requirements.

In February 2014, the Federal Reserve adopted rules to implement certain of these enhanced prudential standards. Beginning in 2015, the rules require publicly traded bank holding companies with $10 billion or more in total consolidated assets to establish risk committees and require bank holding companies with $50 billion or more in total consolidated assets to comply with enhanced liquidity and overall risk management standards. In October 2018, the Federal Reserve and the other federal bank regulators proposed rules that would tailor the application of the enhanced prudential standards to BHCs and depository institutions pursuant to the EGRRCPA amendments, including by raising the asset threshold for application of many of these standards. For example, all publicly traded bank holding companies with $50 billion or more in total consolidated assets would be required to maintain a risk committee.
Financial Privacy
The federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy

policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Anti-Money Laundering and the USA Patriot Act

A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 (the “USA Patriot Act”) substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. Financial institutions are

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also prohibited from entering into specified financial transactions and account relationships and must use enhanced due diligence procedures in their dealings with certain types of high-risk customers and implement a written customer identification program. Financial institutions must take certain steps to assist government agencies in detecting and preventing money laundering and report certain types of suspicious transactions. Regulatory authorities routinely examine financial institutions for compliance with these obligations, and failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required. Regulatory authorities have imposed cease and desist orders and civil money penalties against institutions found to be violating these obligations.

Office of Foreign Assets Control Regulation

The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") administers and enforces economic and trade sanctions against targeted foreign countries and regimes, under authority of various laws, including designated foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. First Commonwealth is responsible for, among other things, blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious legal and reputational consequences, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Cybersecurity

In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If we fail to observe the regulatory guidance, we could be subject to various regulatory sanctions, including financial penalties.

State regulators have also been increasingly active in implementing privacy and cybersecurity standards and regulations. Recently, several states have adopted regulations requiring certain financial institutions to implement cybersecurity programs and providing detailed requirements with respect to these programs, including data encryption requirements. Many states have also recently implemented or modified their data breach notification and data privacy requirements. We expect this trend of state-level activity in those areas to continue, and are continually monitoring developments in the states in which our customers are located.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. We employ an in-depth, layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date we have not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of internet banking, mobile banking and other technology-based products and services by us and our customers. See Item 1A. Risk Factors for a further discussion of risks related to cybersecurity.

Future Legislation and Regulation

Congress may enact legislation from time to time that affects the regulation of the financial services industry, and state legislatures may enact legislation from time to time affecting the regulation of financial institutions chartered by or operating in those states. Federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. The substance or impact of pending or future legislation or regulation, or the application thereof, cannot be predicted, although enactment of the proposed legislation could impact the regulatory structure

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under which we operate and may significantly increase our costs, impede the efficiency of our internal business processes, require us to increase our regulatory capital and modify our business strategy, and limit our ability to pursue business opportunities in an efficient manner. Our business, financial condition, results of operations or prospects may be adversely affected, perhaps materially, as a result.

Availability of Financial Information

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file at the Securities and Exchange Commission's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Our SEC filings are also available to the public on the SEC website at www.sec.gov and on our website at www.fcbanking.com.

We also make available on our website, www.fcbanking.com, and in print to any shareholder who requests them, our Corporate Governance Guidelines, the charters for our Audit, Risk, Compensation and Human Resources, and Governance Committees, and the Code of Conduct and Ethics that applies to all of our directors, officers and employees.

Our Chief Executive Officer has certified to the New York Stock Exchange ("NYSE") that, as of the date of the certification, he was not aware of any violation by First Commonwealth of NYSE's corporate governance listing standards. In addition, our Chief Executive Officer and Chief Financial Officer have made certain certifications concerning the information contained in this report pursuant to Section 302 of the Sarbanes-Oxley Act. The Section 302 certifications appear as Exhibits 31.1 and 31.2 to this annual report on Form 10-K.

ITEM 1A. Risk Factors

As a financial services company, we are subject to a number of risks, many of which are outside of our control. These risks include, but are not limited to:

Changes in interest rates could negatively impact our financial condition and results of operations.

Our results of operations depend substantially on net interest income, which is the difference between interest earned on interest-earning assets (such as investments and loans) and interest paid on interest-bearing liabilities (such as deposits and borrowings). Interest rates are highly sensitive to many factors, including governmental monetary policies and domestic and international economic and political conditions. Conditions such as inflation, recession, unemployment, money supply, and other factors beyond our control may also affect interest rates. If our interest-earning assets mature or reprice more quickly than interest-bearing liabilities in a declining interest rate environment, net interest income could be adversely impacted. Likewise, if interest-bearing liabilities mature or reprice more quickly than interest-earnings assets in a rising interest rate environment, net interest income could be adversely impacted.

Changes in interest rates also can affect the value of loans and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in nonperforming assets and a reduction of income recognized, which could have a material adverse effect on our results of operations and cash flows.

We are subject to extensive government regulation and supervision.

Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not security holders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, policies or supervisory guidance could result in enforcement and other legal actions by Federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, the revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties and/or reputational damage. In this regard, government authorities, including the bank regulatory agencies, are pursuing aggressive enforcement actions with respect compliance and other legal matters involving financial activities, which heightens the risks associated with actual and perceived compliance failures. See "Supervision and Regulation" included in Item 1. Business for a more detailed description of the regulatory requirements applicable to First Commonwealth.

Declines in real estate values could adversely affect our earnings and financial condition.

As of December 31, 2018, approximately 70% of our loans were secured by real estate. These loans consist of residential real estate loans (approximately 27% of total loans), commercial real estate loans (approximately 37% of total loans) and real estate construction loans (approximately 6% of total loans). Declines in real estate values, both within and outside of Pennsylvania, could adversely affect the value of the collateral for these loans, the ability of borrowers to make timely repayment of these loans and our ability to recoup the value of the collateral upon foreclosure, negatively impacting our earnings and financial condition.

Our earnings are significantly affected by general business and economic conditions.

Our operations and profitability are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance and the strength of the United States economy, all of which are beyond our control. A deterioration in economic conditions could result in an increase in loan delinquencies and nonperforming assets, decreases in loan collateral values and a decrease in demand for our products and services, among other things, any of which could have a material adverse impact on our financial condition and results of operations.

Our allowance for credit losses may be insufficient.

All borrowers carry the potential to default and our remedies to recover may not fully satisfy money previously loaned. We maintain an allowance for credit losses, which is a reserve established through a provision for credit losses charged to expense, which represents management’s best estimate of probable credit losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is adequate to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance for credit losses reflects management’s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic conditions and unidentified losses in the current loan portfolio. The determination of the appropriate level of the allowance for credit losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks using existing qualitative and quantitative information, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for credit losses. In addition, bank regulatory agencies periodically review our allowance for credit losses and may require an increase in the provision for credit losses or the recognition of additional loan charge-offs, based on judgments different than those of management. An increase in the allowance for credit losses results in a decrease in net income or losses, and possibly risk-based capital, and may have a material adverse effect on our financial condition and results of operations.

We may be adversely impacted by the transition from LIBOR as a reference rate.

In 2017, the United Kingdom’s Financial Conduct Authority announced that after 2021 it would no longer compel banks to submit the rates required to calculate the London Interbank Offered Rate (“LIBOR”). This announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, at this time, it is not possible to predict whether and to what extent banks will continue to provide submissions for the calculation of LIBOR. Similarly, it is not possible to predict whether LIBOR will continue to be viewed as an acceptable market benchmark, what rate or rates may become accepted alternatives to LIBOR, or what the effect of any such changes in views or alternatives may be on the markets for LIBOR-indexed financial instruments.

We have a significant number of loans, derivative contracts, borrowings and other financial instruments with attributes that are either directly or indirectly dependent on LIBOR. The transition from LIBOR could create considerable costs and additional risk. Since proposed alternative rates are calculated differently, payments under contracts referencing new rates will differ from those referencing LIBOR. The transition will change our market risk profiles, requiring changes to risk and pricing models, valuation tools, product design and hedging strategies. Furthermore, failure to adequately manage this transition process with our customers could adversely impact our reputation. Although we are currently unable to assess what the ultimate impact of the transition from LIBOR will be, failure to adequately manage the transition could have a material adverse effect on our business, financial condition and results of operations.

Acts of cyber-crime may compromise client and company information, disrupt access to our systems or result in loss of client or company assets.

Our business is dependent upon the availability of technology, the Internet and telecommunication systems to enable financial transactions by clients, record and monitor transactions and transmit and receive data to and from clients and third parties. Information security risks have increased significantly due to the use of online, telephone and mobile banking channels by clients and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties. Our technologies, systems, networks and our clients’ devices have been subject to, and are likely to continue to be the target of, cyber-attacks, computer viruses, malicious code, phishing attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our or our clients’ confidential, proprietary and other information, the theft of client assets through fraudulent transactions or disruption of our or our clients' or other third parties' business operations. Any of the foregoing could have a material adverse effect on First Commonwealth's business, financial condition and results of operations.

We must evaluate whether any portion of our recorded goodwill is impaired. Impairment testing may result in a material, non-cash write-down of our goodwill assets and could have a material adverse impact on our results of operations.

At December 31, 2018, goodwill represented approximately 4% of our total assets. We have recorded goodwill because we paid more for some of our businesses than the fair market value of the tangible and separately measurable intangible net assets of those businesses. We test our goodwill and other intangible assets with indefinite lives for impairment at least annually (or whenever events occur which may indicate possible impairment). Goodwill impairment is determined by comparing the fair value of a reporting unit to its carrying amount, including goodwill. If the fair value exceeds the carrying amount, goodwill of the reporting unit is not considered impaired. If the fair value of the reporting unit is less than the carrying amount, goodwill is considered impaired. Determining the fair value of our company requires a high degree of subjective management assumptions. Any changes in key assumptions about our business and its prospects, changes in market conditions or other externalities, for impairment testing purposes could result in a non-cash impairment charge and such a charge could have a material adverse effect on our consolidated results of operations. Changes in the economic environment may adversely affect our earnings, the fair value of our assets and liabilities and our stock price, all of which may increase the risk of goodwill impairment.

First Commonwealth relies on dividends from its subsidiaries for most of its revenues.

First Commonwealth is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenues from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on First Commonwealth's common stock and interest and principal on First Commonwealth's debt. Various federal and/or state laws and regulations limit the amount of dividends that FCB and certain non-bank subsidiaries may pay to First Commonwealth. In the event FCB is unable to pay dividends to First Commonwealth, First Commonwealth may not be able to service debt, pay obligations or pay dividends on its common stock. The inability to receive dividends from FCB could have a material adverse effect on First Commonwealth's business, financial condition and results of operations.

Competition from other financial institutions in originating loans, attracting deposits and providing various financial services may adversely affect our profitability.

FCB faces substantial competition in originating loans and attracting deposits. This competition comes principally from other banks, savings institutions, mortgage banking companies and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of our competitors enjoy advantages, including greater financial resources and higher lending limits, better brand recognition, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. These competitors may offer more favorable pricing through lower interest rates on loans or higher interest rates on deposits, which could force us to match competitive rates and thereby reduce our net interest income.

Negative publicity could damage our reputation.

Reputation risk, or the risk to our earnings and capital from negative public opinion, is inherent in our business. Negative public opinion could adversely affect our ability to keep and attract customers and expose us to adverse legal and regulatory consequences. Negative public opinion could result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance, regulatory compliance, mergers and acquisitions, and disclosure, sharing or inadequate protection of customer information, and from actions taken by government regulators and community organizations in response to that conduct. Because we conduct all of our business under the "First Commonwealth" brand, negative public opinion about one business could affect our other businesses.

An interruption to our information systems could adversely impact our operations.

We rely upon our information systems for operating and monitoring all major aspects of our business, including deposit and loan operations, as well as internal management functions. These systems and our operations could be damaged or interrupted by natural disasters, power loss, network failure, improper operation by our employees, security breaches, computer viruses, intentional attacks by third parties or other unexpected events. Any disruption in the operation of our information systems could adversely impact our operations, which may affect our financial condition, results of operations and cash flows.

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Our controls and procedures may fail or be circumvented.

Our internal controls, disclosure controls and procedures, and corporate governance policies and procedures are based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on First Commonwealth’s business, financial condition and results of operations.

We continually encounter technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse effect on First Commonwealth’s business, financial condition and results of operations.

We may not be able to attract and retain skilled people.

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people can be intense and we may not be able to hire people or to retain them. The unexpected loss of services of key personnel could have a material adverse impact on our business, financial condition and results of operations because of their customer relationships, skills, knowledge of our market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Our operations rely on external vendors.

We rely on certain vendors to provide products and services necessary to maintain the day-to-day operations of First Commonwealth and FCB. In particular, we contracted with an external vendor for our core processing system used to maintain customer and account records, reflect account transactions and activity, and support our customer relationship management systems for substantially all of our deposit and loan customers. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements, because of changes in the vendor’s organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could be disruptive to First Commonwealth’s operations and financial reporting, which could have a material adverse effect on First Commonwealth’s business and, in turn, First Commonwealth’s financial condition and results of operations.

We are subject to environmental liability risk associated with lending activities.

A significant portion of FCB's loan portfolio is secured by real property. During the ordinary course of business, FCB may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property’s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Environmental reviews of real property before initiating foreclosure actions may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on First Commonwealth’s business, financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business.

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. In addition, such events could affect the stability of FCB's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. The occurrence of any such event in the future could have a material adverse effect on our business, which, in turn, could have a material adverse effect on First Commonwealth's financial condition and results of operations.

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Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on First Commonwealth's business, financial condition and results of operations.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions that deal with each other are interconnected as a result of trading, investment, liquidity management, clearing, counterparty and other relationships. Within the financial services industry, loss of public confidence, including through default by any one institution, could lead to liquidity challenges or to defaults by other institutions. Concerns about, or a default by, one institution could lead to significant liquidity problems and losses or defaults by other institutions, as the commercial and financial soundness of many financial institutions is closely related as a result of these credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses or defaults by various institutions. This systemic risk may adversely affect financial intermediaries, such as clearing agencies, banks and exchanges with which we interact on a daily basis or key funding providers such as the Federal Home Loan Banks, any of which could have a material adverse effect on our access to liquidity or otherwise have a material adverse effect on our business, financial condition or results of operations.

First Commonwealth's stock price can be volatile.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. First Commonwealth's stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Actual or anticipated variations in quarterly results of operations.
- Recommendations by securities analysts.
- Operating and stock price performance of other companies that investors deem comparable to First Commonwealth.
- News reports relating to trends, concerns and other issues in the financial services industry.
- Perceptions in the marketplace regarding First Commonwealth and/or its competitors.
- New technology used, or services offered, by competitors.
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving First Commonwealth or its competitors.
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions.
- Changes in government regulations.
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, including real or anticipated changes in the strength of the economy in Pennsylvania and Ohio; industry factors and general economic and political conditions and events, such as economic slowdowns or recessions; interest rate changes or credit loss trends could also cause First Commonwealth's stock price to decrease regardless of operating results.

The trading volume in First Commonwealth's common stock is less than that of other larger financial services companies.

Although First Commonwealth's common stock is listed for trading on the NYSE, the trading volume in its common stock is less than that of other, larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of First Commonwealth's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of First Commonwealth's common stock, significant sales of First Commonwealth's common stock, or the expectation of these sales, could cause First Commonwealth's stock price to fall.

First Commonwealth may not continue to pay dividends on its common stock in the future.

Holders of First Commonwealth common stock are only entitled to receive such dividends as its board of directors may declare out of funds legally available for such payments. Although First Commonwealth has historically declared cash dividends on its common stock, it is not required to do so and may reduce or eliminate its common stock dividend in the future. This could adversely affect the market price of First Commonwealth's common stock. Also, First Commonwealth is a bank holding company, and its ability to declare and pay dividends is dependent on certain federal regulatory considerations, including the guidelines of the FRB regarding capital adequacy and dividends.

As more fully discussed in Part II, Item 8, Financial Statements and Supplementary Data-Note 26, Regulatory Restrictions and Capital Adequacy, which is located elsewhere in this report, the ability of First Commonwealth to declare or pay dividends on its common stock may also be subject to certain restrictions in the event that First Commonwealth elects to defer the payment of interest on its junior subordinated debt securities.

An investment in First Commonwealth's common stock is not an insured deposit.

First Commonwealth's common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in First Commonwealth's common stock is inherently risky for the reasons described in this Risk Factors section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire First Commonwealth's common stock, you could lose some or all of your investment.

Provisions of our articles of incorporation, bylaws and Pennsylvania law, as well as state and federal banking regulations, could delay or prevent a takeover of us by a third party.

Provisions in our articles of incorporation and bylaws, the corporate law of the Commonwealth of Pennsylvania, and state and federal regulations could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise adversely affect the price of our common stock. These provisions include, among other things, advance notice requirements for proposing matters that shareholders may act on at shareholder meetings. In addition, under Pennsylvania law, we are prohibited from engaging in a business combination with any interested shareholder for a period of five years from the date the person became an interested shareholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

Our principal office is located in the old Indiana County courthouse complex, consisting of the former courthouse building and the former sheriff's residence and jail building for Indiana County. This certified Pennsylvania and national historic landmark was built in 1870 and restored by us in the early 1970s. We lease the complex from Indiana County pursuant to a lease agreement that was originally signed in 1973 and has a current term that expires in 2048. The majority of our administrative personnel are also located in two owned buildings in Indiana, Pennsylvania, each of which is in close proximity to our principal office.

First Commonwealth Bank has 137 community banking offices, of which 53 are leased and 84 are owned. We also lease three mortgage loan production offices and three corporate loan production offices. During 2018, we acquired 5 leased branches from Garfield Acquisition Corp. in Cincinnati, Ohio.

While these facilities are adequate to meet our current needs, available space is limited and additional facilities may be required to support future expansion. However, we have no significant plans to lease, purchase or construct additional administrative facilities.

ITEM 3. Legal Proceedings

The information required by this Item is set forth in Part II, Item 8, Note 23, “Contingent Liabilities,” which is incorporated herein by reference in response to this item.

ITEM 4. Mine Safety Disclosures

Not applicable.

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Executive Officers of First Commonwealth Financial Corporation

The name, age and principal occupation for each of the executive officers of First Commonwealth Financial Corporation as of December 31, 2018 is set forth below:

Jane Grebenc, age 60, has served as Executive Vice President and Chief Revenue Officer of First Commonwealth Financial Corporation and President of First Commonwealth Bank since May 31, 2013. Ms. Grebenc's financial services career includes executive leadership roles at a variety of institutions, including Park View Federal Savings Bank, Key Bank, and National City Bank. She was formerly the Executive Vice President in charge of the retail, marketing, IT and operations and the mortgage segments at Park View Federal Savings Bank from 2009 until 2012, the Executive Vice President in charge of the Wealth Segment at Key Bank from 2007 until 2009 and the Executive Vice President / Branch Network at National City Bank prior to 2007.

Brian Karrip, age 58, has served as Executive Vice President and Chief Credit Officer of First Commonwealth Bank since September 2016. Prior to joining First Commonwealth, Mr. Karrip served as Executive Vice President, Specialized Lending for FirstMerit Bank. Prior to joining FirstMerit Bank, Mr. Karrip served as Managing Director and Group Head of Loan Syndications and Sales at KeyBanc Capital Markets. Mr. Karrip’s financial services career also includes 16 years with National City Bank where he held a variety of roles in the commercial lending division and served as Regional President of Michigan and Illinois.

Leonard V. Lombardi, age 59, has served as Executive Vice President and Chief Audit Executive of First Commonwealth Financial Corporation since January 1, 2009. He was formerly Senior Vice President / Loan Review and Audit Manager.

Norman J. Montgomery, age 51, has served as the Executive Vice President of Business Integration of First Commonwealth Bank since May 2011. He oversees First Commonwealth’s product development and assumed oversight of First Commonwealth’s technology and operations functions in July 2012. He served as Senior Vice President/Business Integration of First Commonwealth Bank from September 2007 until May 2011 and previously held positions in the technology, operations, audit and marketing areas.

T. Michael Price, age 56, has served as President and Chief Executive Officer of First Commonwealth Financial Corporation and Chief Executive Officer of First Commonwealth Bank since March 2012. Mr. Price served as President of First Commonwealth Bank from November 2007 to May 2013. From January 1, 2012 to March 7, 2012, he served as Interim President and Chief Executive Officer of First Commonwealth Financial Corporation. He was formerly Chief Executive Officer of the Cincinnati and Northern Kentucky Region of National City Bank from July 2004 to November 2007 and Executive Vice President and Head of Small Business Banking of National City Bank prior to July 2004.

James R. Reske, age 55, joined First Commonwealth Financial Corporation as Executive Vice President, Chief Financial Officer and Treasurer on April 28, 2014. Prior to joining First Commonwealth, Mr. Reske served as Executive Vice President, Chief Financial Officer, and Treasurer at United Community Financial Corporation in Youngstown, Ohio from 2008 until April 2014. Mr. Reske's financial services career includes investment banking roles within the Financial Institutions Groups at Keybanc Capital Markets, Inc. in Cleveland, Ohio and at Morgan Stanley & Company in New York. Mr. Reske also provided expertise and counsel to financial institutions and other organizations on mergers and acquisitions and capital markets activities as an attorney at Wachtell, Lipton, Rosen & Katz, as well as at Sullivan & Cromwell. Earlier in his career, Mr. Reske worked at the Board of Governors of the Federal Reserve System in Washington, DC and at the Federal Reserve Bank of Boston.

Carrie L. Riggle, age 49, has served as Executive Vice President / Human Resources since March 1, 2013. Ms. Riggle has been with First Commonwealth for more than 20 years. Over the course of her tenure, Ms. Riggle has been responsible for the daily operations of the Human Resources function and was actively involved in the establishment and development of a centralized corporate human resources function within the Company.

Matthew C. Tomb, age 42, has served as Executive Vice President, Chief Risk Officer and General Counsel of First Commonwealth Financial Corporation since November 2010. He previously served as Senior Vice President / Legal and Compliance since September 2007. Before joining First Commonwealth, Mr. Tomb practiced law with

Sherman & Howard L.L.C. in Denver, Colorado.

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PART II

ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities

First Commonwealth is listed on the NYSE under the symbol "FCF." As of December 31, 2018, there were approximately 6,014 holders of record of First Commonwealth's common stock. The table below sets forth the high and low sales prices per share and cash dividends declared per share for common stock of First Commonwealth for each quarter during the last two fiscal years.

Period	High Sale	Low Sale	Cash Dividends Per Share
2018			
First Quarter	$ 15.14	$ 13.59	$ 0.08
Second Quarter	16.30	13.88	0.09
Third Quarter	17.72	15.66	0.09
Fourth Quarter	16.21	11.43	0.09

Period	High Sale	Low Sale	Cash Dividends Per Share
2017			
First Quarter	$ 14.59	$ 12.81	$ 0.08
Second Quarter	13.46	12.28	0.08
Third Quarter	14.13	12.14	0.08
Fourth Quarter	15.32	13.78	0.08

Federal and state regulations contain restrictions on the ability of First Commonwealth to pay dividends. For information regarding restrictions on dividends, see Part I, Item 1 "Business—Supervision and Regulation—Restrictions on Dividends" and Part II, Item 8, "Financial Statements and Supplementary Data—Note 26, Regulatory Restrictions and Capital Adequacy." In addition, under the terms of the capital securities issued by First Commonwealth Capital Trust II and III, First Commonwealth could not pay dividends on its common stock if First Commonwealth deferred payments on the junior subordinated debt securities that provide the cash flow for the payments on the capital securities.

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The following five-year performance graph compares the cumulative total shareholder return (assuming reinvestment of dividends) on First Commonwealth's common stock to the SNL U.S. Bank Index and the Russell 2000 Index. The stock performance graph assumes $100 was invested on December 31, 2013, and the cumulative return is measured as of each subsequent fiscal year end.

	Period Ending					
Index	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
First Commonwealth Financial Corporation	100.00	107.99	109.53	176.54	182.55	157.66
Russell 2000	100.00	104.89	100.26	121.63	139.44	124.09
SNL U.S. Bank Index	100.00	111.79	113.69	143.65	169.64	140.98

Unregistered Sales of Equity Securities and Use of Proceeds

The following table details the amount of shares repurchased during the fourth quarter of 2018.

Month Ending:	Total Number of Shares Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 31, 2018	574,500	$ 13.37	574,500	1,282,859
November 30, 2018	1,268,873	13.68	1,268,873	—
December 31, 2018	—	—	—	—
Total	1,843,373	$ 13.58	1,843,373	

(1) Remaining number of shares approved under the Plan is based on the market value of the Company's commons stock of $13.50 as of October 31, 2018.

For additional information, please see Part III, Item 12, "Security ownership of Certain Beneficial Owners." Information called for by this item concerning security ownership of certain beneficial owners and security ownership of management will be included in the Proxy Statement under the headings "Security Ownership of Certain Beneficial Owners" and "Securities Owned by Directors and Management," and is incorporated herein by reference.

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ITEM 6. Selected Financial Data

The following selected financial data is not covered by the auditor's report and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, which follows, and with the Consolidated Financial Statements and related notes.

	Periods Ended December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands, except share data)				
Interest income	$292,257	$250,550	$217,614	$204,071	$202,181
Interest expense	40,035	21,770	18,579	15,595	18,501
Net interest income	252,222	228,780	199,035	188,476	183,680
Provision for credit losses	12,531	5,087	18,480	14,948	11,196
Net interest income after provision for credit losses	239,691	223,693	180,555	173,528	172,484
Net securities gains (losses)	8,102	5,040	617	(153)	550
Other income	80,535	75,291	63,982	61,478	60,309
Other expenses	195,556	200,298	159,925	163,874	171,210
Income before income taxes	132,772	103,726	85,229	70,979	62,133
Income tax provision	25,274	48,561	25,639	20,836	17,680
Net Income	$107,498	$55,165	$59,590	$50,143	$44,453
Per Share Data—Basic					
Net Income	$1.09	$0.58	$0.67	$0.56	$0.48
Dividends declared	$0.35	$0.32	$0.28	$0.28	$0.28
Average shares outstanding	99,036,163	95,220,056	88,851,573	89,356,767	93,114,654
Per Share Data—Diluted					
Net Income	$1.08	$0.58	$0.67	$0.56	$0.48
Average shares outstanding	99,223,513	95,331,037	88,851,573	89,356,767	93,114,654
At End of Period					
Total assets	$7,828,255	$7,308,539	$6,684,018	$6,566,890	$6,360,285
Investment securities	1,335,228	1,183,291	1,187,623	1,333,836	1,354,364
Loans and leases, net of unearned income	5,774,139	5,407,376	4,879,347	4,683,750	4,457,308
Allowance for credit losses	47,764	48,298	50,185	50,812	52,051
Deposits	5,897,992	5,580,705	4,947,408	4,195,894	4,315,511
Short-term borrowings	721,823	707,466	867,943	1,510,825	1,105,876
Subordinated debentures	170,288	72,167	72,167	72,167	72,167
Other long-term debt	7,551	8,161	8,749	9,314	89,459
Shareholders' equity	975,389	888,127	749,929	719,546	716,145
Key Ratios					
Return on average assets	1.42 %	0.77 %	0.89 %	0.78 %	0.71 %
Return on average equity	11.41	6.45	8.02	6.98	6.18
Net loans to deposits ratio	97.09	96.03	97.61	110.42	102.08
Dividends per share as a percent of net income per share	32.11	55.17	41.79	50.00	58.33
Average equity to average assets ratio	12.47	11.86	11.15	11.23	11.45

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ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis represents an overview of the financial condition and the results of operations of First Commonwealth and its subsidiaries, FCB, First Commonwealth Insurance Agency, Inc. ("FCIA"), FRAMAL and First Commonwealth Financial Advisors, Inc. ("FCFA"), as of and for the years ended December 31, 2018, 2017 and 2016. The purpose of this discussion is to focus on information concerning our financial condition and results of operations that is not readily apparent from the Consolidated Financial Statements. In order to obtain a more thorough understanding of this discussion, you should refer to the Consolidated Financial Statements, the notes thereto and other financial information presented in this Annual Report.

Company Overview

First Commonwealth provides a diversified array of consumer and commercial banking services through our bank subsidiary, FCB. We also provide trust and wealth management services through FCB and insurance products through FCIA. At December 31, 2018, FCB operated 137 community banking offices throughout western Pennsylvania and northeastern, central and southwestern Ohio, as well as loan production offices in Pittsburgh, Pennsylvania, and Cleveland, Columbus, Dublin and Hudson, Ohio.

Our consumer services include Internet, mobile and telephone banking, an automated teller machine network, personal checking accounts, interest-earning checking accounts, savings accounts, health savings accounts, insured money market accounts, debit cards, investment certificates, fixed and variable rate certificates of deposit, mortgage loans, secured and unsecured installment loans, construction and real estate loans, safe deposit facilities, credit cards, credit lines with overdraft checking protection and IRA accounts. Commercial banking services include commercial lending, small and high-volume business checking accounts, on-line account management services, ACH origination, payroll direct deposit, commercial cash management services and repurchase agreements. We also provide a variety of trust and asset management services and a full complement of auto, home and business insurance as well as term life insurance. We offer annuities, mutual funds and stock and bond brokerage services through an arrangement with a broker-dealer and insurance brokers. Most of our commercial customers are small and mid-sized businesses in Pennsylvania and Ohio.

As a financial institution with a focus on traditional banking activities, we earn the majority of our revenue through net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and borrowings. Growth in net interest income is dependent upon balance sheet growth and maintaining or increasing our net interest margin, which is net interest income (on a fully taxable-equivalent basis) as a percentage of our average interest-earning assets. We also generate revenue through fees earned on various services and products that we offer to our customers and, less frequently, through sales of assets, such as loans, investments or properties. These revenue sources are offset by provisions for credit losses on loans, operating expenses, income taxes and, less frequently, loss on sale or other-than-temporary impairments on investment securities.

General economic conditions also affect our business by impacting our customers' need for financing, thus affecting loan growth, as well as impacting the credit strength of existing and potential borrowers.

Critical Accounting Policies and Significant Accounting Estimates

First Commonwealth's accounting and reporting policies conform to accounting principles generally accepted in the United States of America ("GAAP") and predominant practice in the banking industry. The preparation of financial statements in accordance with GAAP requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. Over time, these estimates, assumptions and judgments may prove to be inaccurate or vary from actual results and may significantly affect our reported results and financial position for the period presented or in future periods. We currently view the determination of the allowance for credit losses and income taxes to be critical because they are highly dependent on subjective or complex judgments, assumptions and estimates made by management.

Allowance for Credit Losses

We account for the credit risk associated with our lending activities through the allowance and provision for credit losses. The allowance represents management's best estimate of probable losses that have been incurred in our existing loan portfolio as of the balance sheet date. The provision is a periodic charge to earnings in an amount necessary to maintain the allowance at a level that is appropriate based on management's assessment of probable estimated losses. Management determines and reviews

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with the Board of Directors the adequacy of the allowance on a quarterly basis in accordance with the methodology described below.

- Individual loans are selected for review in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 310, "Receivables." These are generally large balance commercial loans and commercial mortgages that are rated less than "satisfactory" based on our internal credit-rating process.
- We assess whether the loans identified for review in step one are "impaired," which means that it is probable that all amounts will not be collected according to the contractual terms of the loan agreement, which generally represents loans that management has placed on nonaccrual status.
- For impaired loans we calculate the estimated fair value of the loans that are selected for review based on observable market prices, discounted cash flows or the value of the underlying collateral and record an allowance if needed.
- We then select pools of homogeneous smaller balance loans, having similar risk characteristics, as well as unimpaired larger commercial loans, that have similar risk characteristics, for evaluation collectively under the provisions of FASB ASC Topic 450, "Contingencies." These smaller balance loans generally include residential mortgages, consumer loans, installment loans and some commercial loans.
- FASB ASC Topic 450 loans are segmented into groups with similar characteristics and an allowance for credit losses is allocated to each segment based on recent loss history and other relevant information.
- We then review the results to determine the appropriate balance of the allowance for credit losses. This review includes consideration of additional factors, such as the mix of loans in the portfolio, the balance of the allowance relative to total loans and nonperforming assets, trends in the overall risk profile in the portfolio, trends in delinquencies and nonaccrual loans, and local and national economic information and industry data, including trends in the industries we believe are higher risk.

There are many factors affecting the allowance for credit losses; some are quantitative, while others require qualitative judgment. These factors require the use of estimates related to the amount and timing of expected future cash flows, appraised values on impaired loans, estimated losses for each loan category based on historical loss experience by category, loss emergence periods for each loan category and consideration of current economic trends and conditions, all of which may be susceptible to significant judgment and change. To the extent that actual outcomes differ from estimates, additional provisions for credit losses could be required that could adversely affect our earnings or financial position in future periods. The loan portfolio represents the largest asset category on our Consolidated Statements of Financial Condition.

Income Taxes

We estimate income tax expense based on amounts expected to be owed to the tax jurisdictions where we conduct business. On a quarterly basis, management assesses the reasonableness of its effective tax rate based upon its current estimate of the amount and components of net income, tax credits and the applicable statutory tax rates expected for the full year.

Deferred income tax assets and liabilities are determined using the asset and liability method and are reported in the Consolidated Statements of Financial Condition. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. Management assesses all available positive and negative evidence on a quarterly basis to estimate if sufficient future taxable income will be generated to utilize the existing deferred tax assets. The amount of future taxable income used in management's valuation is based upon management approved forecasts, evaluation of historical earnings levels, proven ability to raise capital to support growth or during times of economic stress and consideration of prudent and feasible potential tax strategies. If future events differ from our current forecasts, a valuation allowance may be required, which could have a material impact on our financial condition and results of operations.

Accrued taxes represent the net estimated amount due to taxing jurisdictions and are reported in other liabilities in the Consolidated Statements of Financial Condition. Management evaluates and assesses the relative risks and appropriate tax treatment of transactions and filing positions after considering statutes, regulations, judicial precedent and other information and maintains tax accruals consistent with its evaluation of these relative risks and merits. Changes to the estimate of accrued taxes occur periodically due to changes in tax rates, interpretations of tax laws, the status of examinations being conducted by taxing authorities and changes to statutory, judicial and regulatory guidance. These changes, when they occur, can affect deferred taxes and accrued taxes, as well as the current period’s income tax expense and can be significant to our operating results.

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Results of Operations—2018 Compared to 2017

Net Income

Net income for 2018 was $107.5 million, or $1.08 per diluted share, as compared to net income of $55.2 million, or $0.58 per diluted share, in 2017. Impacting net income in 2018 was an increase in net interest income of $23.4 million, growth in noninterest income of $8.3 million and a decline in noninterest expense of $4.7 million primarily due to a decrease in merger related expenses.

Also contributing to the increase in 2018 net income was a decline in the statutory Federal tax rate from 35% to 21%. Results in 2017 were negatively impacted by a $16.7 million non-cash charge related to the revaluation of deferred tax assets recorded in connection with the passage of the Tax Cuts and Jobs Act.

Our return on average equity was 11.4% and our return on average assets was 1.42% for 2018, compared to 6.5% and 0.77%, respectively, for 2017. The previously mentioned charge related to the revaluation of deferred tax assets negatively impacted 2017 return on average equity and return on average assets by 195 and 23 basis points, respectively.

Average diluted shares for the year 2018 were 4% more than the comparable period in 2017 primarily due to the issuance of 2.7 million shares of common stock as a result of the acquisition of Garfield Acquisition Corporation.

Net Interest Income

Net interest income, which is our primary source of revenue, is the difference between interest income from earning assets (loans and securities) and interest expense paid on liabilities (deposits, short-term borrowings and long-term debt). The amount of net interest income is affected by both changes in the level of interest rates and the amount and composition of interest-earning assets and interest-bearing liabilities. The net interest margin is expressed as the percentage of net interest income, on a fully taxable equivalent basis, to average interest-earning assets. To compare the tax exempt asset yields to taxable yields, amounts are adjusted to the pretax equivalent amounts based on the marginal corporate federal income tax rate of 21% in 2018 and 35% in 2017. The taxable equivalent adjustment to net interest income for 2018 was $2.0 million compared to $4.2 million in 2017. Net interest income comprises a majority of our operating revenue (net interest income before provision expense plus noninterest income) at 74% for the years ended December 31, 2018 and 2017.

Net interest income, on a fully taxable equivalent basis, was $254.2 million for the year-ended December 31, 2018, a $21.2 million, or 9%, increase compared to $233.0 million for the same period in 2017. The net interest margin, on a fully taxable equivalent basis, increased 14 basis points to 3.71% in 2018 from 3.57% in 2017. The net interest margin is affected by both changes in the level of interest rates and the amount and composition of interest-earning assets and interest-bearing liabilities, as well as two basis points attributable to the recognition of previously unrecognized interest income on assets that had previously been impaired.

Growth in both the level of interest-earning assets and the rates earned on those assets contributed to the increase in the net interest margin for the year ended December 31, 2018. Average earning assets for the year ended December 31, 2018 increased $318.9 million, or 5%, compared to the year ended December 31, 2017. Interest-sensitive assets totaling $3.6 billion will either reprice or mature over the next twelve months.

The taxable equivalent yield on interest-earning assets was 4.30% for the year ended December 31, 2018, an increase of 40 basis points from the 3.90% yield for the same period in 2017. This increase is largely due to the loan portfolio yield, which improved by 44 basis points when compared to the prior year. Contributing to this increase was the yield on our adjustable and variable rate commercial loan portfolios, which increased 74 basis points largely due to the Federal Reserve increasing short term interest rates 100 basis points in 2018. In addition, the yield on the investment portfolio increased 15 basis points in comparison to the prior year. This increase can be attributed to the runoff of lower yielding securities being replaced with higher yielding investment securities. Additionally, two basis points of the increase in the yield on interest-earning assets can be attributed to the recognition of $1.5 million in previously unrecognized interest due to the sale of one previously impaired commercial loan and our pooled trust preferred security portfolio. Investment portfolio purchases during the year ended December 31, 2018 have been primarily in mortgage-related assets with approximate durations of 30-64 months and corporate securities with durations of approximately five years. The mortgage-related investments have monthly principal payments that will provide for reinvestment opportunities at higher rates if interest rates rise.

Increases in the cost of interest-bearing liabilities partially offset the positive impact of higher yields on interest-earning assets. The cost of interest-bearing liabilities was 0.78% for the year-ended December 31, 2018, compared to 0.44% for the same period in 2017. This increase is primarily due to a 25 basis point increase in the cost of interest-bearing demand deposits, a 73

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basis point increase in the cost of short-term borrowings and a 101 basis point increase in the cost of long-term debt. Contributing to the increase in long term debt was the issuance of $100 million of subordinated debt in the second quarter of 2018. Deposits acquired in our recent acquisitions, along with approximately $50 million of the subordinated debt proceeds and organic growth in consumer checking and savings deposits, contributed to a decline in average short-term borrowings of $248.4 million for the year-ended December 31, 2018 compared to the same period in 2017. Higher market interest rates resulted in the cost of interest-bearing deposits increasing 26 basis points and short-term borrowings increasing 73 basis points in comparison to the same period in the prior year. The impact of the subordinated debt on the cost of interest bearing liabilities was three basis points for the year ended December 31, 2018.

Comparing the year ended December 31, 2018 with the same period in 2017, changes in rates positively impacted net interest income by $9.4 million. The higher yield on interest-earning assets favorably impacted net interest income by $26.2 million, while the increase in the cost of interest-bearing liabilities negatively impacted net interest income by $16.8 million.

Changes in the volume of interest-earning assets and interest-bearing liabilities positively increased net interest income by $11.8 million in the year ended December 31, 2018 compared to the same period in 2017. Higher levels of interest-earning assets resulted in an increase of $13.3 million in interest income, and changes in the volume of interest-bearing liabilities increased interest expense by $1.4 million, primarily due to an increase in long term borrowings and time deposits. Average earning assets for the year ended December 31, 2018 increased $318.9 million, or 4.9%, compared to the same period in 2017. Average loans for the comparable period increased $304.1 million, or 5.8%.

Positively affecting net interest income was a $143.2 million increase in average net free funds at December 31, 2018 as compared to December 31, 2017. Average net free funds are the excess of noninterest-bearing demand deposits, other noninterest-bearing liabilities and shareholders' equity over noninterest-earning assets. The largest component of the increase in net free funds was a $78.1 million increase in average noninterest-bearing demand deposits. Average time deposits for the year ended December 31, 2018 increased $171.3 million, or 30%, compared to the comparable period in 2017, while the average rate paid on time deposits increased 48 basis points. Over the next twelve months $509.2 million in certificates of deposits either mature or reprice.

The following table reconciles interest income in the Consolidated Statements of Income to net interest income adjusted to a fully taxable equivalent basis for the periods presented:

	For the Years Ended December 31,		
	2018	2017	2016
	(dollars in thousands)		
Interest income per Consolidated Statements of Income	$292,257	$250,550	$217,614
Adjustment to fully taxable equivalent basis	1,974	4,225	3,846
Interest income adjusted to fully taxable equivalent basis (non-GAAP)	294,231	254,775	221,460
Interest expense	40,035	21,770	18,579
Net interest income adjusted to fully taxable equivalent basis (non-GAAP)	$254,196	$233,005	$202,881

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The following table provides information regarding the average balances and yields or rates on interest-earning assets and interest-bearing liabilities for the periods ended December 31:

	Average Balance Sheets and Net Interest Analysis								
	2018			2017			2016		
	Average Balance	Income / Expense (a)	Yield or Rate	Average Balance	Income / Expense (a)	Yield or Rate	Average Balance	Income / Expense (a)	Yield or Rate
	(dollars in thousands)								
Assets									
Interest-earning assets:									
Interest-bearing deposits with banks	$5,594	$172	3.07 %	$11,621	$121	1.04 %	$5,799	$27	0.46 %
Tax-free investment securities	67,746	2,084	3.08	67,407	2,495	3.70	62,632	2,305	3.68
Taxable investment securities	1,194,131	33,123	2.77	1,173,711	30,277	2.58	1,221,961	30,745	2.52
Loans, net of unearned income (b)(c)(e)	5,582,651	258,852	4.64	5,278,511	221,882	4.20	4,818,759	188,383	3.91
Total interest-earning assets	6,850,122	294,231	4.30	6,531,250	254,775	3.90	6,109,151	221,460	3.63
Noninterest-earning assets:									
Cash	92,729			90,614			70,408		
Allowance for credit losses	(52,609)			(51,187)			(57,253)		
Other assets	665,114			639,785			538,310		
Total noninterest-earning assets	705,234			679,212			551,465		
Total Assets	$7,555,356			$7,210,462			$6,660,616		
Liabilities and Shareholders’ Equity									
Interest-bearing liabilities:									
Interest-bearing demand deposits (d)	$1,179,439	$4,615	0.39 %	$1,059,840	$1,466	0.14 %	$748,869	$480	0.06 %
Savings deposits (d)	2,441,327	8,624	0.35	2,369,605	4,207	0.18	1,910,333	3,370	0.18
Time deposits	749,408	8,474	1.13	578,158	3,742	0.65	584,429	3,673	0.63
Short-term borrowings	618,957	10,741	1.74	867,391	8,799	1.01	1,387,737	8,076	0.58
Long-term debt	147,915	7,581	5.13	86,391	3,556	4.12	81,197	2,980	3.67
Total interest-bearing liabilities	5,137,046	40,035	0.78	4,961,385	21,770	0.44	4,712,565	18,579	0.39

Noninterest-bearing liabilities and shareholders' equity:								
Noninterest-bearing demand deposits (d)	1,434,233			1,356,125			1,146,189		
Other liabilities	41,740			37,818			58,918		
Shareholders' equity	942,337			855,134			742,944		
Total noninterest-bearing funding sources	2,418,310			2,249,077			1,948,051		
Total Liabilities and Shareholders' Equity	$7,555,356			$7,210,462			$6,660,616		
Net Interest Income and Net Yield on Interest-Earning Assets		$254,196	3.71 %		$233,005	3.57 %		$202,881	3.32 %

(a) Income on interest-earning assets has been computed on a fully taxable equivalent basis using the federal income tax statutory rate of 21% for 2018 and 35% for 2017 and 2016.

(b) Income on nonaccrual loans is accounted for on the cash basis, and the loan balances are included in interest-earning assets.

(c) Loan income includes loan fees.

(d) Average balances do not include reallocations from noninterest-bearing demand deposits and interest-bearing demand deposits into savings deposits which were made for regulatory purposes.

(e) Includes held for sale loans.

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The following table sets forth certain information regarding changes in net interest income attributable to changes in the volume of interest-earning assets and interest-bearing liabilities and changes in the rates for the periods indicated:

	Analysis of Year-to-Year Changes in Net Interest Income					
	2018 Change from 2017			2017 Change from 2016		
	Total Change	Change Due To Volume	Change Due To Rate (a)	Total Change	Change Due To Volume	Change Due To Rate (a)
	(dollars in thousands)					
Interest-earning assets:						
Interest-bearing deposits with banks	$51	$ (63)	$ 114	$94	$ 27	$ 67
Tax-free investment securities	(411)	13	(424)	190	176	14
Taxable investment securities	2,846	527	2,319	(468)	(1,216)	748
Loans	36,970	12,774	24,196	33,499	17,976	15,523
Total interest income (b)	39,456	13,251	26,205	33,315	16,963	16,352
Interest-bearing liabilities:						
Interest-bearing demand deposits	3,149	167	2,982	986	187	799
Savings deposits	4,417	129	4,288	837	827	10
Time deposits	4,732	1,113	3,619	69	(40)	109
Short-term borrowings	1,942	(2,509)	4,451	723	(3,018)	3,741
Long-term debt	4,025	2,535	1,490	576	191	385
Total interest expense	18,265	1,435	16,830	3,191	(1,853)	5,044
Net interest income	$21,191	$ 11,816	$ 9,375	$30,124	$ 18,816	$ 11,308

(a) Changes in interest income or expense not arising solely as a result of volume or rate variances are allocated to rate variances.

(b) Changes in interest income have been computed on a fully taxable equivalent basis using the 21% federal income tax statutory rate for 2018, 35% federal income tax statutory rate for prior years.

Provision for Credit Losses

The provision for credit losses is determined based on management's estimates of the appropriate level of the allowance for credit losses needed to absorb probable losses incurred in the loan portfolio, after giving consideration to charge-offs and recoveries for the period. The provision for credit losses is an amount added to the allowance against which credit losses are charged.

The table below provides a breakout of the provision for credit losses by loan category for the years ended December 31:

	2018		2017	
	Dollars	Percentage	Dollars	Percentage
	(dollars in thousands)			
Commercial, financial, agricultural and other	$451	4 %	$(9,812)	(193)%
Real estate construction	512	4	302	6
Residential real estate	2,162	17	1,164	23
Commercial real estate	4,806	38	10,800	212
Loans to individuals	4,600	37	2,633	52
Total	$12,531	100 %	$5,087	100 %

The provision for credit losses for the year 2018 totaled $12.5 million, an increase of $7.4 million, or 146.3%, compared to the year 2017. The level of provision expense for the year-ended December 31, 2018 is primarily a result of net charge-offs taken to resolve certain nonperforming loans. Provision expense for the commercial, financial, agricultural and other category was impacted by net charge-offs of $4.5 million, of which $3.3 million related to two commercial borrowers whose loans were sold or paid off during 2018. Also impacting provision expense for the commercial, financial, agricultural and other category is an increase in factors related to the migration analysis, a decrease in the historical loss factor and a decline in factors related to the loss emergence period. The provision expense for the residential real estate category can be attributed to $107.5 million of growth in the portfolio compared to December 31, 2017 and $1.0 million in net charge-offs. The provision expense for the commercial real estate category is primarily due to $3.4 million in charge-offs recorded on three commercial loans which were part of the same relationship and were sold or paid off during 2018. Net charge-offs related to loans to individuals were $4.0 million for the year ended December 31, 2018, including $2.2 million related to indirect auto loans and $1.1 million related to personal lines of credit.

The level of provision expense for the year-ended December 31, 2017 is primarily a result of net charge-offs in loans to individuals and commercial, financial, agricultural and other loans, as well as an increase in specific reserves related to nonperforming loans of $0.6 million. Net charge-offs related to loans to individuals were $3.7 million for the year ended December 31, 2017, including $2.4 million related to indirect auto loans and $0.8 million related to personal lines of credit. Net charge-offs on commercial, financial, agricultural and other loans were $2.7 million for the same period. The level of provision expense in the commercial, financial, agricultural and other category, as well as in the commercial real estate category, was also impacted by the Company's periodic assessment of the allowance for loan methodology, the current lending environment, and associated risks for each portfolio, which resulted in changes to certain qualitative factors, such as collateral recovery rates and vacancy rates.

The allowance for credit losses was $47.8 million, or 0.83%, of total loans outstanding and 0.91% of total originated loans at December 31, 2018, compared to $48.3 million, or 0.89%, and 0.96%, respectively, at December 31, 2017. Nonperforming loans as a percentage of total loans decreased to 0.55% at December 31, 2018 from 0.78% at December 31, 2017. The allowance to nonperforming loan ratio was 149.1% as of December 31, 2018 and 114.3% at December 31, 2017. Net charge-offs were $13.1 million for the year-ended December 31, 2018 compared to $7.0 million for the same period in 2017.

The provision is a result of management’s assessment of credit quality statistics and other factors that would have an impact on probable losses in the loan portfolio and the methodology used for determination of the adequacy of the allowance for credit losses. The change in the allowance for credit losses is impacted by the estimated losses within the loan portfolio determined by factors including certain loss events, portfolio migration analysis, loss emergence periods, historical loss experience, delinquency trends, deterioration in collateral values and volatility in economic indicators such as growth in GDP, consumer price index, vacancy rates and unemployment levels. Management believes that the allowance for credit losses is at a level deemed sufficient to absorb losses inherent in the loan portfolio at December 31, 2018.

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A detailed analysis of our credit loss experience for the previous five years is shown below:

	2018	2017	2016	2015	2014
	(dollars in thousands)				
Loans outstanding at end of year	$5,774,139	$5,407,376	$4,879,347	$4,683,750	$4,457,308
Average loans outstanding	$5,582,651	$5,278,511	$4,818,759	$4,553,634	$4,356,566
Balance, beginning of year	$48,298	$50,185	$50,812	$52,051	$54,225
Loans charged off:					
Commercial, financial, agricultural and other	5,294	6,634	19,603	11,429	8,911
Real estate construction	—	—	—	8	296
Residential real estate	1,313	1,287	1,189	1,539	3,153
Commercial real estate	3,930	340	570	1,538	1,148
Loans to individuals	4,576	4,248	4,943	4,354	3,964
Total loans charged off	15,113	12,509	26,305	18,868	17,472
Recoveries of loans previously charged off:					
Commercial, financial, agricultural and other	788	3,901	4,164	1,097	734
Real estate construction	141	470	562	84	1,340
Residential real estate	361	371	481	587	650
Commercial real estate	153	278	1,522	229	612
Loans to individuals	605	515	469	684	766
Total recoveries	2,048	5,535	7,198	2,681	4,102
Net charge-offs	13,065	6,974	19,107	16,187	13,370
Provision charged to expense	12,531	5,087	18,480	14,948	11,196
Balance, end of year	$47,764	$48,298	$50,185	$50,812	$52,051
Ratios:					
Net charge-offs as a percentage of average loans outstanding	0.23 %	0.13 %	0.40 %	0.36 %	0.31 %
Allowance for credit losses as a percentage of end-of-period loans outstanding	0.83 %	0.89 %	1.03 %	1.08 %	1.17 %

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Noninterest Income

The components of noninterest income for each year in the three-year period ended December 31 are as follows:

	2018	2017	2016	2018 compared to 2017 $ Change	% Change
	(dollars in thousands)				
Noninterest Income:					
Trust income	$7,901	$7,098	$5,366	$803	11 %
Service charges on deposit accounts	18,175	18,579	15,869	(404)	(2)
Insurance and retail brokerage commissions	7,426	8,807	7,964	(1,381)	(16)
Income from bank owned life insurance	6,686	5,699	5,381	987	17
Card related interchange income	20,187	18,780	14,955	1,407	7
Swap fee income	1,874	2,005	2,359	(131)	(7)
Other income	6,790	7,677	6,372	(887)	(12)
Subtotal	69,039	68,645	58,266	394	1
Net securities gains	8,102	5,040	617	3,062	61
Gain on sale of mortgage loans	5,436	5,366	4,086	70	1
Gain on sale of loans and other assets	5,273	1,753	1,411	3,520	201
Derivative mark to market	787	(473)	219	1,260	(266)
Total noninterest income	$88,637	$80,331	$64,599	$8,306	10 %

Noninterest income, excluding net securities gains, gain on sale of loans and other assets and the derivatives mark to market, increased $0.4 million, or 1%, in 2018. Card-related interchange income increased $1.4 million, due to growth in customer accounts and transactions, including $0.5 million which is attributable to the Garfield and DCB acquisitions. Income from bank owned life insurance increased $1.0 million, primarily due to $0.9 million death claim benefits recognized in the year ended December 31, 2018. Trust income increased $0.8 million, of which $0.2 million can be attributed to accounts obtained in the DCB acquisition. Insurance and retail brokerage commissions decreased $1.4 million as a result of $2.5 million in producer commission expense that is netted against revenue in 2018 but was included as salary expense in 2017. This change is a result of Topic 606, the new revenue recognition standard that was adopted January 1, 2018. Additionally, other income decreased $0.9 million, all of which is due to certain revenues being netted against expenses as a result of adoption of Topic 606.

Total noninterest income increased $8.3 million, or 10%, in comparison to the year ended December 31, 2017. The most significant change, other than the changes noted above, includes a $3.1 million increase in net securities gains resulting from the redemption of two of our pooled trust preferred securities and the sale of the remaining pooled trust preferred portfolio, a $3.5 million increase in the gain on sale of loans and other assets primarily due to a $1.2 million gain recognized on the sale of a restructured commercial loan, and a $1.3 million increase in the mark to market adjustment on interest rate swaps entered into for our commercial loan customers. This adjustment does not reflect a realized gain on the swaps, but rather relates to a change in fair value due to movements in corporate bond spreads and swap rates.

If the Company's total assets would equal or exceed $10 billion we would no longer qualify for exemption from the interchange fee cap included in the Dodd-Frank Act. The estimated impact of this change would decrease interchange income by $8.4 million.

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Noninterest Expense

The components of noninterest expense for each year in the three-year period ended December 31 are as follows:

	2018	2017	2016	2018 Compared to 2017 $ Change	% Change
	(dollars in thousands)				
Noninterest Expense:					
Salaries and employee benefits	$105,115	$103,714	$87,125	$1,401	1 %
Net occupancy	17,219	15,648	13,150	1,571	10
Furniture and equipment	14,247	13,508	11,624	739	5
Data processing	10,470	9,090	7,429	1,380	15
Advertising and promotion	3,956	3,786	2,601	170	4
Pennsylvania shares tax	4,875	4,209	3,825	666	16
Intangible amortization	3,217	3,081	547	136	4
Collection and repossession	2,762	1,905	2,250	857	45
Other professional fees and services	4,473	4,761	3,915	(288)	(6)
FDIC insurance	2,007	3,210	3,903	(1,203)	(37)
Other operating expenses	23,336	23,289	17,808	47	—
Subtotal	191,677	186,201	154,177	5,476	3
Loss on sale or write-down of assets	1,080	1,834	1,155	(754)	(41)
Litigation and operational losses	1,162	2,050	1,420	(888)	(43)
Merger and acquisition related	1,637	10,213	3,173	(8,576)	(84)
Total noninterest expense	$195,556	$200,298	$159,925	$(4,742)	(2)%

Noninterest expense, excluding the loss on sale or write-down of assets, litigation and operational losses, and merger and acquisition related expense, increased $5.5 million, or 3%, for the year ended 2018 compared to 2017. Contributing to the 2018 increase is a $1.4 million increase in salaries and employee benefits resulting from a higher number of full-time equivalent employees due to the Garfield acquisition and continued expansion of our mortgage and commercial banking businesses. The change in salaries and employee benefits was also impacted by $2.5 million of expense recognized in 2017 for a one-time bonus of $1,500 paid to all full and part-time employees (other than the top five named executive officers) following the passage of the Tax Cuts and Jobs Act. The Garfield and DCB acquisitions accounted for $0.4 million of the $1.6 million increase in net occupancy expense, $0.1 million of the increase in furniture and equipment expense and all of the $0.1 million increase in intangible amortization.

Data processing expense increased $1.4 million due to additional volume associated with increased debit cards and card usage, as well as an increase in usage of digital channels. The $1.2 million decrease in FDIC insurance expense was primarily related to a decrease in our base assessment rate.

Merger related expenses totaled $1.6 million and $10.2 million for the years 2018 and 2017, respectively. Expenses in 2018 reflect expenses related to the acquisition of Garfield while expenses in 2017 and 2016 reflect expenses related to the acquisition of DCB and 13 FirstMerit branches, respectively.

Income Tax

The provision for income taxes of $25.3 million in 2018 reflects a decrease of $23.3 million compared to the provision for income taxes in 2017, despite a $29.0 million increase in the level of income before taxes. The lower provision for income taxes can be attributed to the Tax Cut and Jobs Act passed in December 2017, which decreased the statutory Federal tax rate from 35% to 21%, and a $16.7 million non-cash charge recorded in 2017 for the revaluation of deferred tax assets in connection with the passage of the Tax Cuts and Jobs Act.

The effective tax rate was 19% and 47% for tax expense in 2018 and 2017, respectively. Excluding the $16.7 million charge related to the revaluation of deferred tax assets, the effective tax rate for 2017 would have been 31%. We ordinarily generate an annual effective tax rate that is less than the statutory rate due to benefits resulting from tax-exempt interest and income from bank owned life insurance, which are relatively consistent regardless of the level of pretax income. Additionally, the year ended December 31, 2018 included a $0.6 million further adjustment to the deferred tax asset adjustment recorded in 2017.

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Financial Condition

First Commonwealth’s total assets increased $519.7 million in 2018. Loans, including loans held for sale, increased $363.8 million, or 7%, while investments increased $149.6 million, or 13.1%.

Loan growth in 2018 was impacted by $184.5 million of loans acquired as part of the Garfield acquisition, including $5.2 million in commercial, financial, agricultural and other, $6.7 million in real estate construction, $65.6 million in residential real estate, $101.0 million in commercial real estate and $2.9 million in loans to individuals.

During 2018, approximately $204.3 million in investment securities were sold, called or matured. Some of these securities were lower yielding securities in comparison to the total portfolio yield and, as such, their replacement contributed to the increase in the yield earned on the portfolio. In total, $338.2 million in mortgage-backed securities, $5.0 million in corporate securities and $2.5 million in municipal securities were purchased in 2018 to help replace runoff from the portfolio while maintaining a reduced risk profile.

First Commonwealth’s total liabilities increased $432.5 million, or 7%, in 2018. Deposits increased $317.3 million, or 6%, including $141.3 million in deposits obtained as part of the Garfield acquisition. Short-term debt increased $14.4 million or 2%, based on liquidity needs, and long-term debt increased $97.1 million, or 110%, primarily due to the issuance of $100 million in subordinated debt in the second quarter of 2018.

Total shareholders' equity increased $87.3 million in 2018. Growth in shareholders' equity was a result of net income of $107.5 million and $41.6 million in common stock issued in relation to the Garfield acquisition and, partially offset by $34.8 million in dividends declared, a $5.2 million decrease in accumulated other comprehensive income and $26.2 million in stock repurchases.

Loan Portfolio

Following is a summary of our loan portfolio as of December 31:

	2018 Amount	%	2017 Amount	%	2016 Amount	%	2015 Amount	%	2014 Amount	%
	(dollars in thousands)									
Commercial, financial, agricultural and other	$1,138,473	20 %	$1,163,383	22 %	$1,139,547	23 %	$1,150,906	25 %	$1,052,109	24 %
Real estate construction	358,978	6	248,868	5	219,621	5	220,736	5	120,785	3
Residential real estate	1,562,405	27	1,426,370	26	1,229,192	25	1,224,465	26	1,226,344	27
Commercial real estate	2,123,544	37	2,019,096	37	1,742,210	36	1,479,000	31	1,405,256	31
Loans to individuals	590,739	10	549,659	10	548,777	11	608,643	13	652,814	15
Total loans and leases net of unearned income	$5,774,139	100%	$5,407,376	100%	$4,879,347	100%	$4,683,750	100%	$4,457,308	100%

The loan portfolio totaled $5.8 billion as of December 31, 2018, reflecting growth of $366.8 million, or 7%, compared to December 31, 2017. Loan growth was experienced in all categories, except for commercial, financial, agricultural and other loans, with real estate construction and residential real estate categories providing the majority of the growth. Real estate construction loans increased $110.1 million, or 44.2%, with $94.5 million resulting from growth in commercial construction projects primarily in Pennsylvania and Ohio and $15.6 million due to growth in consumer construction. Commercial real estate loans increased $104.4 million, or 5.2%, of which $101.0 million was acquired as part of the Garfield acquisition. Residential real estate loans increased $136.0 million, or 9.5%, due to growth in our mortgage banking area as well as $65.6 million in mortgage loans acquired from Garfield. Growth in the loans to individuals category was largely due to growth in indirect auto loans. Commercial, financial, agricultural and other loans decreased $24.9 million, or 2.1%, as a result of growth in this category being offset by runoff and prepayments. The majority of our loan portfolio is with borrowers located in Pennsylvania. The Company expanded into the Ohio market area with the opening of a loan production office in Cleveland, Ohio in 2013, the acquisition of First Community Bank of Columbus, Ohio in the fourth quarter of 2015, the purchase of 13 FirstMerit Bank, NA branches in northern Ohio in December 2016, the acquisition of DCB Financial of Columbus, Ohio in May 2017 and the acquisition of Garfield in Cincinnati, Ohio in May 2018. As of December 31, 2018 and 2017, there were no concentrations of loans relating to any industry in excess of 10% of total loans.

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As of December 31, 2018, criticized loans (i.e., loans designated OAEM, substandard, impaired or doubtful) decreased $2.8 million, or 2%, from December 31, 2017. Criticized loans totaled $127.2 million at December 31, 2018 and represented 2% of the total loan portfolio. Additionally, delinquencies on accruing loans decreased $2.9 million, or 22%, at December 31, 2018 compared to December 31, 2017. As of December 31, 2018, nonaccrual loans decreased $7.4 million, or 24%, compared to December 31, 2017. However, nonaccrual loan balances as of December 31, 2018 include $6.0 million related to a commercial credit that was paid in full in January 2019.

Final loan maturities and rate sensitivities of the loan portfolio excluding consumer installment and mortgage loans at December 31, 2018 were as follows:

	Within One Year	One to 5 Years	After 5 Years	Total
	(dollars in thousands)			
Commercial, financial, agricultural and other	$180,467	$587,766	$369,426	$1,137,659
Real estate construction (a)	45,215	187,982	71,402	304,599
Commercial real estate	239,459	789,654	1,094,253	2,123,366
Other	7,409	26,617	111,789	145,815
Totals	$472,550	$1,592,019	$1,646,870	$3,711,439
Loans at fixed interest rates		544,795	390,055	
Loans at variable interest rates		1,047,224	1,256,815	
Totals		$1,592,019	$1,646,870	

(a) The maturity of real estate construction loans include term commitments that follow the construction period. Loans with these term commitments will be moved to the commercial real estate category when the construction phase of the project is completed.

First Commonwealth has a legal lending limit of $118.1 million to any one borrower or closely related group of borrowers, but has established lower thresholds for credit risk management.

Nonperforming Loans

Nonperforming loans include nonaccrual loans and restructured loans. Nonaccrual loans represent loans on which interest accruals have been discontinued. Restructured loans are those loans whose terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of the deteriorating financial position of the borrower under terms not available in the market.

We discontinue interest accruals on a loan when, based on current information and events, it is probable that we will be unable to fully collect principal or interest due according to the contractual terms of the loan. Consumer loans are placed in nonaccrual status at 150 days past due. Other types of loans are typically placed in nonaccrual status when there is evidence of a significantly weakened financial condition or principal and interest is 90 days or more delinquent. Interest received on a nonaccrual loan is normally applied as a reduction to loan principal rather than interest income utilizing the cost recovery methodology of revenue recognition.

Nonperforming loans are closely monitored on an ongoing basis as part of our loan review and work-out process. The probable risk of loss on these loans is evaluated by comparing the loan balance to the fair value of any underlying collateral and the present value of projected future cash flows. Losses are recognized when a loss is probable and the amount is reasonably estimable.

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The following is a comparison of nonperforming and impaired assets and the effects on interest due to nonaccrual loans for the period ended December 31:

	2018	2017	2016	2015	2014
	(dollars in thousands)				
Nonperforming Loans:					
Loans on nonaccrual basis	$11,509	$19,455	$16,454	$24,345	$25,715
Troubled debt restructured loans on nonaccrual basis	11,761	11,222	11,569	12,360	16,952
Troubled debt restructured loans on accrual basis	8,757	11,563	13,790	14,139	12,584
Total nonperforming loans	$32,027	$42,240	$41,813	$50,844	$55,251
Loans past due in excess of 90 days and still accruing	$1,582	$1,854	$2,131	$2,455	$2,619
Other real estate owned	$3,935	$2,765	$6,805	$9,398	$7,197
Loans outstanding at end of period	$5,774,139	$5,407,376	$4,879,347	$4,683,750	$4,457,308
Average loans outstanding	$5,582,651	$5,278,511	$4,818,759	$4,553,634	$4,356,566
Nonperforming loans as a percentage of total loans	0.55 %	0.78 %	0.86 %	1.09 %	1.24 %
Provision for credit losses	$12,531	$5,087	$18,480	$14,948	$11,196
Allowance for credit losses	$47,764	$48,298	$50,185	$50,812	$52,051
Net charge-offs	$13,065	$6,974	$19,107	$16,187	$13,370
Net charge-offs as a percentage of average loans outstanding	0.23 %	0.13 %	0.40 %	0.36 %	0.31 %
Provision for credit losses as a percentage of net charge-offs	95.91 %	72.94 %	96.72 %	92.35 %	83.74 %
Allowance for credit losses as a percentage of end-of-period loans outstanding (a)	0.83 %	0.89 %	1.03 %	1.08 %	1.17 %
Allowance for credit losses as a percentage of nonperforming loans (a)	149.14 %	114.34 %	120.02 %	99.94 %	94.21 %
Gross income that would have been recorded at original rates	$1,428	$2,079	$1,296	$572	$784
Interest that was reflected in income	256	783	533	—	—
Net reduction to interest income due to nonaccrual	$1,172	$1,296	$763	$572	$784

(a) End of period loans and nonperforming loans exclude loans held for sale.

Nonperforming loans decreased $10.2 million to $32.0 million at December 31, 2018, compared to $42.2 million at December 31, 2017. Nonperforming loans as a percentage of total loans decreased to 0.6% from 0.8% at December 31, 2018 compared to December 31, 2017. Included in nonperforming loans at December 31, 2018, was a $6.0 million loan to a commercial borrower that paid off in full subsequent to December 31, 2018.

Also included in nonperforming loans are troubled debt restructured loans (“TDRs”). TDRs are those loans whose terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of the deteriorating financial position of the borrower under terms not available in the market. TDRs decreased $2.3 million during 2018. For additional information on TDRs please refer to Note 11 “Loans and Allowance for Credit Losses.”

Net charge-offs were $13.1 million in 2018 compared to $7.0 million for the year 2017. The most significant credit losses recognized during the year include $3.4 million in charge-offs recognized on one commercial real estate relationship and $3.2 million for a commercial loan that was transferred to held for sale and subsequently sold. Net charge-offs in the loans to individual category totaled $4.0 million for 2018, primarily due to charge-offs of indirect auto loans. Additional detail on credit risk is included in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” under “Provision for Credit Losses,” “Allowance for Credit Losses" and "Credit Risk.”

Provision for credit losses as a percentage of net charge-offs increased to 95.9% for the year ended December 31, 2018 from 72.9% for the year ended December 31, 2017.

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Allowance for Credit Losses

Following is a summary of the allocation of the allowance for credit losses at December 31:

	2018		2017		2016		2015		2014	
	Allowance Amount	% (a)	Allowance Amount	% (a)	Allowance Amount	% (a)	Allowance Amount	% (a)	Allowance Amount	% (a)
	(dollars in thousands)									
Commercial, financial, agricultural and other	$19,374	20%	$23,429	22%	$35,974	23%	$31,035	25%	$29,627	24%
Real estate construction	2,002	6	1,349	5	577	5	887	5	2,063	3
Residential real estate	3,969	27	2,759	26	2,511	25	2,606	26	3,664	27
Commercial real estate	18,386	37	17,357	37	6,619	36	11,924	31	11,881	31
Loans to individuals	4,033	10	3,404	10	4,504	11	4,360	13	4,816	15
Total	$47,764		$48,298		$50,185		$50,812		$52,051	
Allowance for credit losses as percentage of end-of-period loans outstanding	0.83 %		0.89 %		1.03 %		1.08 %		1.17 %	

(a) Represents the ratio of loans in each category to total loans.

The allowance for credit losses decreased $0.5 million from December 31, 2017 to December 31, 2018. The allowance for credit losses as a percentage of end-of-period loans outstanding was 0.8% at December 31, 2018 compared to 0.9% at December 31, 2017. The allowance for credit losses includes both a general reserve for performing loans and specific reserves for impaired loans. Comparing December 31, 2018 to December 31, 2017, the general reserve for performing loans decreased from 0.83% to 0.80% of total performing loans. General reserves as a percentage of non-impaired originated loans were 0.88% at December 31, 2018 compared to 0.90% at December 31, 2017. Specific reserves decreased from 8.9% of nonperforming loans at December 31, 2017 to 5.1% of nonperforming loans at December 31, 2018. The allowance for credit losses as a percentage of nonperforming loans was 149.1% and 114.3% at December 31, 2018 and 2017, respectively.

The allowance for credit losses represents management’s estimate of probable losses incurred in the loan portfolio at a specific point in time. This estimate includes losses associated with specifically identified loans, as well as estimated probable credit losses inherent in the remainder of the loan portfolio. Additions are made to the allowance through both periodic provisions charged to income and recoveries of losses previously incurred. Reductions to the allowance occur as loans are charged off. Management evaluates the adequacy of the allowance at least quarterly, and in doing so relies on various factors including, but not limited to, assessment of historical loss experience, delinquency and nonaccrual trends, portfolio growth, net realizable value of collateral and current economic conditions. This evaluation is subjective and requires material estimates that may change over time. For a description of the methodology used to calculate the allowance for credit losses, please refer to “Critical Accounting Policies and Significant Accounting Estimates—Allowance for Credit Losses.”

Management reviews local and national economic information and industry data, including trends in the industries we believe are indicative of higher risk to our portfolio. Factors reviewed by management include employment trends, macroeconomic trends, commercial real estate trends and the overall lending environment.

Investment Portfolio

Marketable securities that we hold in our investment portfolio, which are classified as “securities available for sale,” may be a source of liquidity; however, we do not anticipate liquidating the investments prior to maturity.

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Following is a detail schedule of the amortized cost of securities available for sale as of December 31:

	2018	2017	2016
	(dollars in thousands)		
Obligations of U.S. Government Agencies:			
Mortgage-Backed Securities—Residential	$9,011	$10,556	$15,143
Mortgage-Backed Securities—Commercial	169,633	24,611	—
Obligations of U.S. Government-Sponsored Enterprises:			
Mortgage-Backed Securities—Residential	686,906	632,422	683,601
Mortgage-Backed Securities—Commercial	—	—	1
Other Government-Sponsored Enterprises	10,000	1,098	16,700
Obligations of States and Political Subdivisions	27,592	27,083	27,075
Corporate Securities	20,912	15,907	5,903
Pooled Trust Preferred Collateralized Debt Obligations	—	27,499	39,989
Total Debt Securities	924,054	739,176	788,412
Equities	—	1,670	1,670
Total Securities Available for Sale	$924,054	$740,846	$790,082

As of December 31, 2018, securities available for sale had a fair value of $909.2 million. Gross unrealized gains were $3.0 million and gross unrealized losses were $17.8 million.

The following is a schedule of the contractual maturity distribution of securities available for sale at December 31, 2018.

	U.S. Government Agencies and Corporations	States and Political Subdivisions	Other Securities	Total Amortized Cost (a)	Weighted Average Yield (b)
	(dollars in thousands)				
Within 1 year	$118	$ —	$4,000	$4,118	2.06 %
After 1 but within 5 years	4,111	2,273	14,983	21,367	3.25
After 5 but within 10 years	255,938	25,319	—	281,257	2.19
After 10 years	615,383	—	1,929	617,312	2.99
Total	$875,550	$ 27,592	$20,912	$924,054	2.75 %

(a) Equities are excluded from this schedule because they have an indefinite maturity.
(b) Yields are calculated on a taxable equivalent basis.

Mortgage-backed securities, which include mortgage-backed obligations of U.S. Government agencies and obligations of U.S. Government-sponsored enterprises, have contractual maturities ranging from less than one year to approximately 30 years and have anticipated average lives to maturity ranging from less than one year to approximately eight years.

The available for sale investment portfolio increased $183.2 million, or 25%, at December 31, 2018 compared to 2017. Available for sale investment purchases of $332.0 million were partially offset by the sale, call or maturity of $156.6 million in investments. Liquidity provided from sales, calls and maturities was utilized to fund growth in the loan portfolio.

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Following is a detail schedule of the amortized cost of securities held to maturity as of December 31:

	2018	2017	2016
	(dollars in thousands)		
Obligations of U.S. Government Agencies:			
Mortgage-Backed Securities—Residential	$3,635	$3,925	$4,297
Mortgage-Backed Securities—Commercial	55,221	58,249	34,444
Obligations of U.S. Government-Sponsored Enterprises:			
Mortgage-Backed Securities—Residential	279,109	305,126	280,430
Mortgage-Backed Securities—Commercial	13,159	14,056	14,675
Obligations of States and Political Subdivisions	42,331	40,540	38,667
Debt Securities Issued by Foreign Governments	400	200	—
Total Securities Held to Maturity	$393,855	$422,096	$372,513

The following is a schedule of the contractual maturity distribution of securities held to maturity at December 31, 2018.

	U.S. Government Agencies and Corporations	States and Political Subdivisions	Other Securities	Total Amortized Cost	Weighted Average Yield
	(dollars in thousands)				
Within 1 year	$—	$ 521	$ 0	$521	1.87 %
After 1 but within 5 years	—	6,818	400	7,218	2.37
After 5 but within 10 years	13,159	34,992	0	48,151	2.87
After 10 years	337,965	0	—	337,965	2.50
Total	$351,124	$ 42,331	$ 400	$393,855	2.54 %

The held to maturity investment portfolio decreased $28.2 million, or 7%, at December 31, 2018 compared to 2017. Held to maturity investment purchases of $20.7 million were offset by the sale, call or maturity of $47.6 million in investments.

See Note 9 “Investment Securities,” Note 10 “Impairment of Investment Securities” and Note 19 “Fair Values of Assets and Liabilities” for additional information related to the investment portfolio.

Deposits

Total deposits increased $317.3 million, or 6%, in 2018, with $141.3 million of the growth resulting from the Garfield acquisition. Growth was experienced in all deposit categories.

Time deposits of $100 thousand or more had remaining maturities as follows as of the end of each year in the three-year period ended December 31:

	2018		2017		2016	
	Amount	%	Amount	%	Amount	%
	(dollars in thousands)					
3 months or less	$51,619	13 %	$47,964	23 %	$38,366	26 %
Over 3 months through 6 months	59,201	15	22,101	11	27,371	19
Over 6 months through 12 months	133,285	35	68,174	32	29,013	20
Over 12 months	140,429	37	72,142	34	50,621	35
Total	$384,534	100%	$210,381	100%	$145,371	100%

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Short-Term Borrowings and Long-Term Debt

Short-term borrowings increased $14.4 million, or 2%, from $707.5 million as of December 31, 2017 to $721.8 million at December 31, 2018. Long-term debt increased $97.1 million, or 110%, from $87.9 million at December 31, 2017 to $185.1 million at December 31, 2018 as a result of the issuance of $100 million of subordinated debt in the second quarter of 2018. For additional information concerning our short-term borrowings, subordinated debentures and other long-term debt, please refer to Note 16 “Short-term Borrowings,” Note 17 “Subordinated Debentures” and Note 18 “Other Long-term Debt” of the Consolidated Financial Statements.

Contractual Obligations and Off-Balance Sheet Arrangements

The table below sets forth our contractual obligations to make future payments as of December 31, 2018. For a more detailed description of each category of obligation, refer to the note in our Consolidated Financial Statements indicated in the table below.

	Footnote Number Reference	1 Year or Less	After 1 But Within 3 Years	After 3 But Within 5 Years	After 5 Years	Total
	(dollars in thousands)					
FHLB advances	18	$631	$ 1,336	$ 1,443	$4,141	$7,551
Subordinated debentures	17	—	—	—	170,288	170,288
Operating leases	13	4,945	9,971	9,832	44,777	69,525
Total contractual obligations		$5,576	$ 11,307	$ 11,275	$219,206	$247,364

The table above excludes our cash obligations upon maturity of certificates of deposit, which is set forth in Note 15 “Interest-Bearing Deposits” of the Consolidated Financial Statements.

In addition, see Note 12 “Commitments and Letters of Credit” for detail related to our off-balance sheet commitments to extend credit, financial standby letters of credit, performance standby letters of credit and commercial letters of credit as of December 31, 2018. Commitments to extend credit, standby letters of credit and commercial letters of credit do not necessarily represent future cash requirements since it is unknown if the borrower will draw upon these commitments and often these commitments expire without being drawn upon. As of December 31, 2018, a reserve for probable losses of $5.0 million was recorded for unused commitments and letters of credit.

Liquidity

Liquidity refers to our ability to meet the cash flow requirements of depositors and borrowers as well as our operating cash needs with cost-effective funding. Liquidity risk arises from the possibility that we may not be able to meet our financial obligations and operating cash needs or may become overly reliant upon external funding sources. In order to manage this risk, our Board of Directors has established a Liquidity Policy that identifies primary sources of liquidity, establishes procedures for monitoring and measuring liquidity and quantifies minimum liquidity requirements based on limits approved by our Board of Directors. This policy designates our Asset/Liability Committee (“ALCO”) as the body responsible for meeting these objectives. The ALCO, which includes members of executive management, reviews liquidity on a periodic basis and approves significant changes in strategies that affect balance sheet or cash flow positions. Liquidity is centrally managed on a daily basis by our Treasury Department, which monitors it by using such measures as a 30 day liquidity stress analysis, liquidity gap ratios and noncore funding ratios.

We generate funds to meet our cash flow needs primarily through the core deposit base of FCB and the maturity or repayment of loans and other interest-earning assets, including investments. Core deposits are the most stable source of liquidity a bank can have due to the long-term relationship with a deposit customer. The level of deposits during any period is sometimes influenced by factors outside of management’s control, such as the level of short-term and long-term market interest rates and yields offered on competing investments, such as money market mutual funds. Deposits increased $317.3 million, or 6%, during 2018, and comprised 86% of total liabilities at December 31, 2018, as compared to 87% at December 31, 2017. Proceeds from the sale, maturity and redemption of investment securities totaled $204.3 million during 2018 and provided liquidity to fund loans as well as the purchase of additional investment securities.

We also have available unused wholesale sources of liquidity, including overnight federal funds and repurchase agreements, advances from the Federal Home Loan Bank of Pittsburgh, borrowings through the discount window at the Federal Reserve Bank of Cleveland and access to certificates of deposit through brokers. We have increased our borrowing capacity at the Federal Reserve by establishing a Borrower-in-Custody of Collateral arrangement that enables us to pledge certain loans, not being used as collateral at the Federal Home Loan Bank, as collateral for borrowings at the Federal Reserve. At December 31, 2018 our borrowing capacity at the Federal Reserve related to this program was $768.7 million and there were no amounts outstanding. Additionally, as of December 31, 2018, our maximum borrowing capacity at the Federal Home Loan Bank of Pittsburgh was $1.6 billion and as of that date amounts used against this capacity included $0.6 billion in outstanding borrowings.

We participate in the Certificate of Deposit Account Registry Services (“CDARS”) program as part of an ALCO strategy to increase and diversify funding sources. As of December 31, 2018, our maximum borrowing capacity under this program was $1.2 billion and as of that date there was $6.7 million outstanding. We also participate in a reciprocal program which allows our depositors to receive expanded FDIC coverage by placing multiple certificates of deposit at other CDARS member banks. As of December 31, 2018, our outstanding certificates of deposits from this program have an average weighted rate of 1.26% and an average original term of 336 days.

We also have available unused federal funds lines with four correspondent banks. These lines have an aggregate commitment of $205.0 million with $11.0 million outstanding as of December 31, 2018.

The liquidity needs of First Commonwealth on an unconsolidated basis (the "Parent Company") consist primarily of operating expenses, debt service payments and dividend payments to our stockholders, which totaled $42.6 million for the year ended December 31, 2018, as well as any cash necessary to repurchase our shares, which totaled $26.2 million for the year ended December 31, 2018. The primary source of liquidity for the Parent Company is dividends from subsidiaries. The Parent Company had $72.2 million in junior subordinated debentures and cash and interest-bearing deposits of $21.5 million at December 31, 2018. At the end of 2018, the Parent Company had a $15.0 million short-term, unsecured revolving line of credit with another financial institution. As of December 31, 2018, there were no amounts outstanding under this line. The Parent Company has the ability to enhance its liquidity position by raising capital or incurring debt.

Refer to “Financial Condition” above for additional information concerning our deposits, loan portfolio, investment securities and borrowings.

Market Risk

Market risk refers to potential losses arising from changes in interest rates, foreign exchange rates, equity prices and commodity prices. Our market risk is composed primarily of interest rate risk. Interest rate risk is comprised of repricing risk, basis risk, yield curve risk and options risk. Repricing risk arises from differences in the cash flow or repricing between asset and liability portfolios. Basis risk arises when asset and liability portfolios are related to different market rate indices, which do not always change by the same amount. Yield curve risk arises when asset and liability portfolios are related to different maturities on a given yield curve; when the yield curve changes shape, the risk position is altered. Options risk arises from “embedded options” within asset and liability products as certain borrowers have the option to prepay their loans when rates fall, while certain depositors can redeem or withdraw their deposits early when rates rise.

The process by which we manage our interest rate risk is called asset/liability management. The goals of our asset/liability management are increasing net interest income without taking undue interest rate risk or material loss of net market value of our equity, while maintaining adequate liquidity. Net interest income is increased by growing earning assets and increasing the difference between the rate earned on earning assets and the rate paid on interest-bearing liabilities. Liquidity is measured by the ability to meet both depositors’ and credit customers’ requirements.

We use an asset/liability model to measure our interest rate risk. Interest rate risk measures include earnings simulation and gap analysis. Gap analysis is a static measure that does not incorporate assumptions regarding future events. Gap analysis, while a helpful diagnostic tool, displays cash flows for only a single rate environment. Net interest income simulations explicitly measure the exposure to earnings from changes in market rates of interest. Under simulation analysis, our current financial position is combined with assumptions regarding future business to calculate net interest income under various hypothetical rate scenarios. Our net interest income simulations assume a level balance sheet whereby new volume equals run-off. The ALCO reviews earnings simulations over multiple years under various interest rate scenarios. Reviewing these various measures provides us with a reasonably comprehensive view of our interest rate profile.

The following gap analysis compares the difference between the amount of interest-earning assets and interest-bearing liabilities subject to repricing over a period of time. The ratio of rate sensitive assets to rate sensitive liabilities repricing within a one year period was 0.74 and 0.73 at December 31, 2018 and 2017, respectively. A ratio of less than one indicates a higher level of repricing liabilities over repricing assets over the next twelve months. The level of First Commonwealth's ratio is largely driven by the modeling of interest-bearing non-maturity deposits, which are included in the analysis as repricing within one year.

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Following is the gap analysis as of December 31:

	2018					
	0-90 Days	91-180 Days	181-365 Days	Cumulative 0-365 Days	Over 1 Year Through 5 Years	Over 5 Years
	(dollars in thousands)					
Loans	$2,659,890	$291,134	$439,098	$3,390,122	$1,802,605	$569,659
Investments	81,971	60,654	99,288	241,913	612,407	468,916
Other interest-earning assets	3,013	—	—	3,013	—	—
Total interest-sensitive assets (ISA)	2,744,874	351,788	538,386	3,635,048	2,415,012	1,038,575
Certificates of deposit	116,469	116,664	276,101	509,234	338,148	2,834
Other deposits	3,581,563	—	—	3,581,563	—	—
Borrowings	794,206	218	443	794,867	54,080	57,932
Total interest-sensitive liabilities (ISL)	4,492,238	116,882	276,544	4,885,664	392,228	60,766
Gap	$(1,747,364)	$234,906	$261,842	$(1,250,616)	$2,022,784	$977,809
ISA/ISL	0.61	3.01	1.95	0.74	6.16	17.09
Gap/Total assets	22.32 %	3.00 %	3.34 %	15.98 %	25.84 %	12.49 %

	2017					
	0-90 Days	91-180 Days	181-365 Days	Cumulative 0-365 Days	Over 1 Year Through 5 Years	Over 5 Years
	(dollars in thousands)					
Loans	$2,662,906	$214,139	$359,790	$3,236,835	$1,633,236	$521,478
Investments	79,484	45,983	84,001	209,468	525,391	434,919
Other interest-earning assets	8,668	—	—	8,668	—	—
Total interest-sensitive assets (ISA)	2,751,058	260,122	443,791	3,454,971	2,158,627	956,397
Certificates of deposit	139,920	71,178	165,083	376,181	235,037	3,595
Other deposits	3,549,121	—	—	3,549,121	—	