

1ST SOURCE CORP
Form 10-Q
October 19, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from _____ to _____

Commission file number 0-6233

(Exact name of registrant as specified in its charter)

INDIANA

35-1068133

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

100 North Michigan Street

South Bend, IN

46601

(Address of principal executive offices) (Zip Code)

(574) 235-2000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

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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

Number of shares of common stock outstanding as of October 13, 2017 — 25,936,130 shares

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1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited - Dollars in thousands)

	September 30, 2017	December 31, 2016
ASSETS		
Cash and due from banks	\$ 64,636	\$ 58,578
Federal funds sold and interest bearing deposits with other banks	34,788	49,726
Investment securities available-for-sale	893,973	850,467
Other investments	25,953	22,458
Mortgages held for sale	11,000	15,849
Loans and leases, net of unearned discount:		
Commercial and agricultural	893,174	812,264
Auto and light truck	505,126	411,764
Medium and heavy duty truck	287,975	294,790
Aircraft	816,120	802,414
Construction equipment	541,838	495,925
Commercial real estate	740,345	719,170
Residential real estate and home equity	524,071	521,931
Consumer	128,069	129,813
Total loans and leases	4,436,718	4,188,071
Reserve for loan and lease losses	(93,372)	(88,543)
Net loans and leases	4,343,346	4,099,528
Equipment owned under operating leases, net	145,975	118,793
Net premises and equipment	53,324	56,708
Goodwill and intangible assets	83,795	84,102
Accrued income and other assets	149,945	130,059
Total assets	\$ 5,806,735	\$ 5,486,268
LIABILITIES		
Deposits:		
Noninterest-bearing demand	\$ 1,019,106	\$ 991,256
Interest-bearing deposits:		
Interest-bearing demand	1,493,187	1,471,526
Savings	825,147	814,326
Time	1,236,272	1,056,652
Total interest-bearing deposits	3,554,606	3,342,504
Total deposits	4,573,712	4,333,760
Short-term borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	148,001	162,913
Other short-term borrowings	168,764	129,030
Total short-term borrowings	316,765	291,943
Long-term debt and mandatorily redeemable securities	70,482	74,308
Subordinated notes	58,764	58,764
Accrued expenses and other liabilities	76,515	54,843
Total liabilities	5,096,238	4,813,618

SHAREHOLDERS' EQUITY

Preferred stock; no par value		
Authorized 10,000,000 shares; none issued or outstanding	—	—
Common stock; no par value		
Authorized 40,000,000 shares; issued 28,205,674 at September 30, 2017 and December 31, 2016	436,538	436,538
Retained earnings	327,149	290,824
Cost of common stock in treasury (2,269,544 shares at September 30, 2017 and 2,329,909 shares at December 31, 2016)	(54,643	) (56,056)
Accumulated other comprehensive income	1,453	1,344
Total shareholders' equity	710,497	672,650
Total liabilities and shareholders' equity	\$ 5,806,735	\$ 5,486,268

The accompanying notes are a part of the consolidated financial statements.

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1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited - Dollars in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Interest income:				
Loans and leases	\$50,429	\$ 44,965	\$143,345	\$ 131,592
Investment securities, taxable	3,048	2,384	9,932	8,504
Investment securities, tax-exempt	628	672	1,988	2,061
Other	325	279	935	879
Total interest income	54,430	48,300	156,200	143,036
Interest expense:				
Deposits	5,186	3,879	13,431	11,440
Short-term borrowings	396	150	895	430
Subordinated notes	1,022	1,055	3,132	3,165
Long-term debt and mandatorily redeemable securities	597	522	1,925	1,725
Total interest expense	7,201	5,606	19,383	16,760
Net interest income	47,229	42,694	136,817	126,276
Provision for loan and lease losses	1,620	2,067	5,358	5,091
Net interest income after provision for loan and lease losses	45,609	40,627	131,459	121,185
Noninterest income:				
Trust and wealth advisory	5,037	4,691	15,665	14,422
Service charges on deposit accounts	2,468	2,366	7,171	6,749
Debit card	2,983	2,745	8,719	8,160
Mortgage banking	1,486	1,334	3,737	3,495
Insurance commissions	1,429	1,350	4,506	4,146
Equipment rental	7,917	6,657	22,335	19,247
Gains on investment securities available-for-sale	1,007	989	2,757	790
Other	3,265	2,533	8,145	9,580
Total noninterest income	25,592	22,665	73,035	66,589
Noninterest expense:				
Salaries and employee benefits	22,016	22,136	64,073	64,681
Net occupancy	2,806	2,435	7,768	7,243
Furniture and equipment	5,363	4,898	15,264	14,499
Depreciation – leased equipment	6,565	5,570	18,541	16,115
Professional fees	1,765	1,244	4,514	3,653
Supplies and communication	1,316	1,256	3,911	4,138
FDIC and other insurance	693	647	1,889	2,437
Business development and marketing	1,199	1,263	4,352	3,268
Loan and lease collection and repossession	1,093	324	2,058	1,136
Other	1,644	1,372	4,314	4,714
Total noninterest expense	44,460	41,145	126,684	121,884
Income before income taxes	26,741	22,147	77,810	65,890
Income tax expense	9,559	7,883	27,753	23,329
Net income	\$17,182	\$ 14,264	\$50,057	\$ 42,561
Per common share:				
Basic net income per common share	\$0.66	\$ 0.55	\$1.92	\$ 1.63

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Diluted net income per common share	\$0.66	\$ 0.55	\$1.92	\$ 1.63
Cash dividends	\$0.19	\$ 0.18	\$0.56	\$ 0.54
Basic weighted average common shares outstanding	25,935,867	25,867,169	25,922,218	25,881,360
Diluted weighted average common shares outstanding	25,935,867	25,867,169	25,922,218	25,881,360

The accompanying notes are a part of the consolidated financial statements.

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1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited - Dollars in thousands)

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
Net income	\$17,182	\$14,264	\$50,057	\$42,561
Other comprehensive (loss) income:				
Change in unrealized (depreciation) appreciation of available-for-sale securities	(568)	(905)	2,932	5,742
Reclassification adjustment for realized (gains) losses included in net income	(1,007)	(989)	(2,757)	(790)
Income tax effect	591	711	(66)	(1,859)
Other comprehensive (loss) income, net of tax	(984)	(1,183)	109	3,093
Comprehensive income	\$16,198	\$13,081	\$50,166	\$45,654

The accompanying notes are a part of the consolidated financial statements.

1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited - Dollars in thousands, except per share amounts)

	Preferred Stock	Common Stock	Retained Earnings	Cost of Common Stock in Treasury	Accumulated Other Comprehensive Income (Loss), Net	Total
Balance at January 1, 2016	\$ —	—\$436,538	\$251,812	\$(50,852)	\$ 6,555	\$644,053
Net income	—	—	42,561	—	—	42,561
Other comprehensive income	—	—	—	—	3,093	3,093
Issuance of 109,887 common shares under stock based compensation awards, including related tax effects	—	—	(4)	2,620	—	2,616
Cost of 270,378 shares of common stock acquired for treasury	—	—	—	(8,030)	—	(8,030)
Common stock cash dividend (\$0.54 per share)	—	—	(14,034)	—	—	(14,034)
Balance at September 30, 2016	\$ —	—\$436,538	\$280,335	\$(56,262)	\$ 9,648	\$670,259
Balance at January 1, 2017	\$ —	—\$436,538	\$290,824	\$(56,056)	\$ 1,344	\$672,650
Cumulative-effect adjustment	—	—	(65)	—	—	(65)
Balance at January 1, 2017, adjusted	—	436,538	290,759	(56,056)	1,344	672,585
Net income	—	—	50,057	—	—	50,057
Other comprehensive income	—	—	—	—	109	109
Issuance of 61,265 common shares under stock based compensation awards	—	—	890	1,454	—	2,344
Cost of 900 shares of common stock acquired for treasury	—	—	—	(41)	—	(41)
Common stock cash dividend (\$0.56 per share)	—	—	(14,557)	—	—	(14,557)
Balance at September 30, 2017	\$ —	—\$436,538	\$327,149	\$(54,643)	\$ 1,453	\$710,497

The accompanying notes are a part of the consolidated financial statements.

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1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited - Dollars in thousands)

	Nine Months Ended September 30,	
	2017	2016
Operating activities:		
Net income	\$50,057	\$42,561
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	5,358	5,091
Depreciation of premises and equipment	4,309	3,897
Depreciation of equipment owned and leased to others	18,541	16,115
Stock-based compensation	2,158	2,036
Amortization of investment securities premiums and accretion of discounts, net	4,206	4,594
Amortization of mortgage servicing rights	821	1,133
Deferred income taxes	(4,230)	82
(Gains) losses on investment securities available-for-sale	(2,757)	(790)
Originations of loans held for sale, net of principal collected	(75,387)	(88,161)
Proceeds from the sales of loans held for sale	82,572	80,474
Net gain on sale of loans held for sale	(2,336)	(2,474)
Net loss (gain) on sale of other real estate and repossessions	48	(154)
Change in interest receivable	(2,863)	(1,204)
Change in interest payable	1,293	1,089
Change in other assets	(3,054)	(2,896)
Change in other liabilities	16,445	4,820
Other	3,499	(367)
Net change in operating activities	98,680	65,846
Investing activities:		
Proceeds from sales of investment securities available-for-sale	2,927	5,139
Proceeds from maturities and paydowns of investment securities available-for-sale	133,541	158,178
Purchases of investment securities available-for-sale	(181,752)	(199,056)
Proceeds from liquidation of partnership investment	—	2,903
Net change in other investments	(3,495)	(485)
Loans sold or participated to others	13,049	—
Net change in loans and leases	(269,881)	(191,881)
Net change in equipment owned under operating leases	(45,723)	(23,627)
Purchases of premises and equipment	(2,801)	(5,532)
Proceeds from sales of other real estate and repossessions	2,761	1,523
Net change in investing activities	(351,374)	(252,838)
Financing activities:		
Net change in demand deposits and savings accounts	60,332	211,917
Net change in time deposits	179,620	25,935
Net change in short-term borrowings	24,822	(17,222)
Proceeds from issuance of long-term debt	19,999	10,837
Payments on long-term debt	(26,015)	(5,928)
Stock issued under stock purchase plans	153	116
Acquisition of treasury stock	(41)	(8,030)
Cash dividends paid on common stock	(15,056)	(14,530)

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Net change in financing activities	243,814	203,095
Net change in cash and cash equivalents	(8,880)	16,103
Cash and cash equivalents, beginning of year	108,304	79,721
Cash and cash equivalents, end of period	\$99,424	\$95,824
Supplemental Information:		
Non-cash transactions:		
Loans transferred to other real estate and repossessed assets	\$7,656	\$2,850
Common stock matching contribution to Employee Stock Ownership and Profit Sharing Plan	1,426	800
The accompanying notes are a part of the consolidated financial statements.		

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1ST SOURCE CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Accounting Policies

1st Source Corporation is a bank holding company headquartered in South Bend, Indiana that provides, through its subsidiaries (collectively referred to as “1st Source” or “the Company”), a broad array of financial products and services.

Basis of Presentation – The accompanying unaudited consolidated financial statements reflect all adjustments (all of which are normal and recurring in nature) which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, the results of operations, changes in comprehensive income, changes in shareholders’ equity, and cash flows for the periods presented. These unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been omitted.

The Notes to the Consolidated Financial Statements appearing in 1st Source Corporation’s Annual Report on Form 10-K (2016 Annual Report), which include descriptions of significant accounting policies, should be read in conjunction with these interim financial statements. The Consolidated Statement of Financial Condition at December 31, 2016 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. Certain amounts in the prior period consolidated financial statements have been reclassified to conform to the current year presentation.

Use of Estimates in the Preparation of Financial Statements – Financial statements prepared in accordance with GAAP require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expense during the reporting period. Actual results could differ from those estimates.

Loans and Leases – Loans are stated at the principal amount outstanding, net of unamortized deferred loan origination fees and costs and net of unearned income. Interest income is accrued as earned based on unpaid principal balances. Origination fees and direct loan and lease origination costs are deferred and the net amount amortized to interest income over the estimated life of the related loan or lease. Loan commitment fees are deferred and amortized into other income over the commitment period.

Direct financing leases are carried at the aggregate of lease payments plus estimated residual value of the leased property, net of unamortized deferred lease origination fees and costs and unearned income. Interest income on direct financing leases is recognized over the term of the lease to achieve a constant periodic rate of return on the outstanding investment.

The accrual of interest on loans and leases is discontinued when a loan or lease becomes contractually delinquent for 90 days, or when an individual analysis of a borrower’s credit worthiness indicates a credit should be placed on nonperforming status, except for residential mortgage loans and consumer loans that are well secured and in the process of collection. Residential mortgage loans are placed on nonaccrual at the time the loan is placed in foreclosure. When interest accruals are discontinued, interest credited to income in the current year is reversed and interest accrued in the prior year is charged to the reserve for loan and lease losses. However, in some cases, the Company may elect to continue the accrual of interest when the net realizable value of collateral is sufficient to cover the principal and accrued interest. When a loan or lease is classified as nonaccrual and the future collectibility of the recorded loan or lease balance is doubtful, collections on interest and principal are applied as a reduction to principal outstanding. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured, which is typically evidenced by a sustained repayment performance of at least six months.

A loan or lease is considered impaired, based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan or lease agreement. Interest on impaired loans and leases, which are not classified as nonaccrual, is recognized on the accrual basis. The Company evaluates loans and leases exceeding \$100,000 for impairment and establishes a specific reserve as a component of the reserve for loan and lease losses when it is probable all amounts

due will not be collected pursuant to the contractual terms of the loan or lease and the recorded investment in the loan or lease exceeds its fair value.

Loans and leases that have been modified and economic concessions have been granted to borrowers who have experienced financial difficulties are considered a troubled debt restructuring (TDR) and, by definition, are deemed an impaired loan. These concessions typically result from the Company's loss mitigation activities and may include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower's sustained repayment performance for a reasonable period of at least six months.

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When the Company modifies loans and leases in a TDR, it evaluates any possible impairment similar to other impaired loans based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan or lease agreement, or uses the current fair value of the collateral, less selling costs for collateral dependent loans. If the Company determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through a reserve for loan and lease losses estimate or a charge-off to the reserve for loan and lease losses. In periods subsequent to modification, the Company evaluates all TDRs, including those that have payment defaults, for possible impairment and recognizes impairment through the reserve for loan and lease losses.

Note 2 — Recent Accounting Pronouncements

Share Based Payment Awards: In May 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-09 “Compensation - Stock Compensation (Topic 718), Scope of Modification Accounting.” These amendments provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The amendments should be applied on a prospective basis to an award modified on or after the adoption date. The Company is assessing the impact of ASU 2017-09 and does not expect it to have a material impact on its accounting and disclosures.

Premium Amortization: In March 2017, the FASB issued ASU No. 2017-08 “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities.” These amendments shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is assessing the impact of ASU 2017-08 on its accounting and disclosures.

Sale of Nonfinancial Assets: In February 2017, the FASB issued ASU No. 2017-05 “Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets.” The amendments clarify that a financial asset is within the scope of Subtopic 610-20 if it meets the definition of an in substance nonfinancial asset. The amendments also define the term in substance nonfinancial asset. The amendments clarify that nonfinancial assets within the scope of Subtopic 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. For example, a parent may transfer control of nonfinancial assets by transferring ownership interests in a consolidated subsidiary. A contract that includes the transfer of ownership interests in one or more consolidated subsidiaries is within the scope of Subtopic 610-20 if substantially all of the fair value of the assets that are promised to the counterparty in a contract is concentrated in nonfinancial assets. The amendments clarify that an entity should identify each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it. The guidance is effective for public business entities for annual periods beginning after December 15, 2017 and interim periods therein. Entities may use either a full or modified approach to adopt the ASU. The Company is assessing ASU 2017-05 and does not expect it to have a material impact on its accounting and disclosures.

Simplifying the Test for Goodwill Impairment: In January 2017, the FASB issued ASU No. 2017-04 “Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment.” These amendments eliminate Step 2 from the goodwill impairment test. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The guidance is effective for annual or any interim

goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. ASU 2017-04 should be adopted on a prospective basis. The Company has assessed ASU 2017-04 and does not expect it to have a material impact on its accounting and disclosures.

Business Combinations: In January 2017, the FASB issued ASU No. 2017-01 “Business Combinations (Topic 805) - Clarifying the Definition of a Business.” ASU 2017-01 provides amendments to clarify the definition of a business and affect all companies and other reporting organizations that must determine whether they have acquired or sold a business. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied prospectively as of the beginning of the period of adoption. Early adoption is permitted under certain circumstances. The Company has assessed ASU 2017-01 and does not expect it to have a material impact on its accounting and disclosures.

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Restricted Cash: In November 2016, the FASB issued ASU No. 2016-18 “Statement of Cash Flows (Topic 230) - Restricted Cash.” ASU 2016-18 provides amendments to cash flow statement classification and presentation to explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied using a retrospective transition method to each period presented. Early adoption is permitted, including adoption in an interim period. The Company has assessed ASU 2016-18 and does not expect a material impact on its accounting and disclosures.

Intra-Entity Transfers of Assets Other Than Inventory: In October 2016, the FASB issued ASU No. 2016-16 “Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory.” The amendments in ASU 2016-16 require an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments eliminate the exception for an intra-entity transfer of an asset other than inventory. The amendments do not include new disclosure requirements; however existing disclosure requirements might be applicable when accounting for the current and deferred income taxes for an intra-entity transfer of an asset other than inventory. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. The Company has assessed ASU 2016-16 and does not expect a material impact on its accounting and disclosures.

Classification of Certain Cash Receipts and Cash Payments: In August 2016, the FASB issued ASU No. 2016-15 “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments.” ASU 2016-15 provides cash flow statement classification guidance for certain transactions including how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied retrospectively. Early adoption is permitted, including adoption in an interim period. The Company has assessed ASU 2016-15 and does not expect a material impact on its accounting and disclosures.

Measurement of Credit Losses on Financial Instruments: In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments-Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments.” The provisions of ASU 2016-13 were issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. ASU 2016-13 requires that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in ASU 2016-13 eliminate the probable incurred loss recognition in current GAAP and reflect an entity’s current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security.

ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company has an implementation team working through the provisions of ASU 2016-13 including assessing the impact on its accounting and disclosures.

Share Based Payment Accounting: In March 2016, the FASB issued ASU No. 2016-09 “Compensation - Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment Accounting.” ASU 2016-09 requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee’s shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election for forfeitures as they occur. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted. The Company adopted ASU 2016-09 on January 1, 2017 on a modified retrospective method through a cumulative adjustment to retained earnings related to the policy election to account for forfeitures as they occur. The adoption of ASU 2016-09 did not have a material impact on its accounting and disclosures.

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Leases: In February 2016, the FASB issued ASU No. 2016-02 “Leases (Topic 842).” ASU 2016-02 establishes a right of use model that requires a lessee to record a right of use asset and a lease liability for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. A lease will be treated as sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn’t convey risks and rewards or control, an operating lease results. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, with certain practical expedients available. Early adoption is permitted. The Company has an implementation team working through the provisions of ASU 2016-02 including a review of all leases to assess the impact on its accounting, disclosures and the election of certain practical expedients. It is expected that the Company will recognize discounted right of use assets and lease liabilities (estimated between \$12 and \$15 million as of January 1, 2017) upon adoption on January 1, 2019. The estimates will change due to changes in the lease portfolio.

Recognition and Measurement of Financial Instruments: In January 2016, the FASB issued ASU No. 2016-01 “Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 is intended to improve the recognition and measurement of financial instruments by requiring equity investments to be measured at fair value with changes in fair value recognized in net income; requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured and amortized at cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. The Company is continuing to assess the impact of ASU 2016-01 on its accounting for equity investments, fair value disclosures and other disclosure requirements.

Revenue from Contracts with Customers: In May 2014, the FASB issued ASU No. 2014-09 “Revenue from Contracts with Customers (Topic 606).” The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. In March 2016, the FASB issued final amendments (ASU No. 2016-08 and ASU No. 2016-10) to clarify the implementation guidance for principal versus agent considerations, identifying performance obligations and the accounting for licenses of intellectual property. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. In May 2016, the FASB issued final amendments (ASU No. 2016-12 and ASU 2016-11) to address narrow-scope improvements to the guidance on collectibility, non-cash consideration, completed contracts at transition and to provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. Additionally, the amendments included a rescission of SEC guidance because of ASU 2014-09 related to revenue and expense recognition for freight services in process,

accounting for shipping and handling fees and costs, and accounting for consideration given by a vendor to a customer. In December 2016, the FASB issued final guidance (ASU 2016-20) that allows entities not to make quantitative disclosures about performance obligations in certain cases and requires entities that use any of the new or previously existing optional exemptions to expand their qualitative disclosures. It also makes 12 additional technical corrections and improvements to the new revenue standard. These amendments are effective upon the adoption of ASU 2014-09. The Company's revenue is comprised of net interest income, which is explicitly excluded from the scope of ASU 2014-09, and noninterest income. ASU 2014-09 may require the Company to change how it recognizes certain recurring revenue streams related to noninterest income. The Company continues to follow the guidance from the FASB and the Transition Resource Group for Revenue Recognition related to noninterest income and expects the adoption of ASU 2014-09 on January 1, 2018 will not have a material impact on its accounting and disclosures.

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Note 3. Investment Securities Available-For-Sale

The following table shows investment securities available-for-sale.

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2017				
U.S. Treasury and Federal agencies securities	\$ 460,282	\$ 453	\$ (3,109)	) \$ 457,626
U.S. States and political subdivisions securities	122,178	1,407	(459)	) 123,126
Mortgage-backed securities — Federal agencies	276,791	1,989	(1,923)	) 276,857
Corporate debt securities	31,599	48	(168)	) 31,479
Foreign government and other securities	200	2	—	202
Total debt securities	891,050	3,899	(5,659)	) 889,290
Marketable equity securities	598	4,098	(13)	) 4,683
Total investment securities available-for-sale	\$ 891,648	\$ 7,997	\$ (5,672)	) \$ 893,973

December 31, 2016

U.S. Treasury and Federal agencies securities	\$ 424,495	\$ 809	\$ (4,471)	) \$ 420,833
U.S. States and political subdivisions securities	133,509	1,036	(1,570)	) 132,975
Mortgage-backed securities — Federal agencies	252,981	2,175	(2,582)	) 252,574
Corporate debt securities	35,266	111	(301)	) 35,076
Foreign government and other securities	800	7	—	807
Total debt securities	847,051	4,138	(8,924)	) 842,265
Marketable equity securities	1,265	7,007	(70)	) 8,202
Total investment securities available-for-sale	\$ 848,316	\$ 11,145	\$ (8,994)	) \$ 850,467

At September 30, 2017 and December 31, 2016, the residential mortgage-backed securities held by the Company consisted primarily of GNMA, FNMA and FHLMC pass-through certificates which are guaranteed by those respective agencies of the United States government (Government Sponsored Enterprise, GSEs).

The following table shows the contractual maturities of investments in debt securities available-for-sale at September 30, 2017. Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ 119,304	\$ 119,624
Due after one year through five years	448,884	446,985
Due after five years through ten years	46,071	45,824
Due after ten years	—	—
Mortgage-backed securities	276,791	276,857
Total debt securities available-for-sale	\$ 891,050	\$ 889,290

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The following table summarizes gross unrealized losses and fair value by investment category and age.

(Dollars in thousands)	Less than 12 Months		12 months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2017						
U.S. Treasury and Federal agencies securities	\$ 238,505	\$ (1,482)	\$ 97,156	\$ (1,627)	\$ 335,661	\$ (3,109)
U.S. States and political subdivisions securities	17,119	(107)	22,213	(352)	39,332	(459)
Mortgage-backed securities - Federal agencies	108,863	(1,043)	59,233	(880)	168,096	(1,923)
Corporate debt securities	9,789	(13)	8,134	(155)	17,923	(168)
Foreign government and other securities	—	—	—	—	—	—
Total debt securities	374,276	(2,645)	186,736	(3,014)	561,012	(5,659)
Marketable equity securities	149	(12)	3	(1)	152	(13)
Total investment securities available-for-sale	\$ 374,425	\$ (2,657)	\$ 186,739	\$ (3,015)	\$ 561,164	\$ (5,672)
December 31, 2016						
U.S. Treasury and Federal agencies securities	\$ 263,680	\$ (4,471)	\$ —	\$ —	\$ 263,680	\$ (4,471)
U.S. States and political subdivisions securities	74,129	(1,515)	3,337	(55)	77,466	(1,570)
Mortgage-backed securities - Federal agencies	168,554	(2,341)	5,102	(241)	173,656	(2,582)
Corporate debt securities	13,312	(301)	—	—	13,312	(301)
Foreign government and other securities	—	—	—	—	—	—
Total debt securities	519,675	(8,628)	8,439	(296)	528,114	(8,924)
Marketable equity securities	280	(70)	4	—	284	(70)
Total investment securities available-for-sale	\$ 519,955	\$ (8,698)	\$ 8,443	\$ (296)	\$ 528,398	\$ (8,994)

The initial indication of potential other-than-temporary-impairment (OTTI) for both debt and equity securities is a decline in fair value below amortized cost. Quarterly, the impaired securities are analyzed on a qualitative and quantitative basis in determining OTTI. Declines in the fair value of available-for-sale debt securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of impairment related to other factors is recognized in other comprehensive income. In estimating OTTI losses, the Company considers among other things, (i) the length of time and the extent to which fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) whether it is more likely than not that the Company will not have to sell any such securities before a recovery of cost.

At September 30, 2017, the Company does not have the intent to sell any of the available-for-sale securities in the table above and believes that it is more likely than not, that it will not have to sell any such securities before an anticipated recovery of cost. Primarily the unrealized losses on debt securities are due to increases in market rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover on all debt securities as they approach their maturity date or re-pricing date or if market yields for such investments decline. The Company does not believe any of the securities are impaired due to reasons of credit quality.

The following table shows the gross realized gains and losses from the securities available-for-sale portfolio, including marketable equity securities. Realized gains and losses of all securities are computed using the specific identification cost basis.

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Gross realized gains	\$ 1,007	\$ 989	\$ 2,947	\$ 1,084
Gross realized losses	—	—	—	—

OTTI losses