

Cardiovascular Systems Inc
Form 10-Q
May 13, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-Q

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

**For the quarterly period ended March 31, 2011
Commission File No. 000-52082**

**CARDIOVASCULAR SYSTEMS, INC.
(Exact name of registrant as specified in its charter)**

**Delaware
(State or Other Jurisdiction of
Incorporation or Organization)**

**No. 41-1698056
(IRS Employer
Identification No.)**

**651 Campus Drive
St. Paul, Minnesota 55112-3495
(Address of Principal Executive Offices)
Registrant's telephone number (651) 259-1600**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller
reporting company)

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

The number of shares outstanding of the registrant's common stock as of May 11, 2011 was: Common Stock, \$0.001 par value per share, 16,218,170 shares.

Cardiovascular Systems, Inc.
Consolidated Financial Statements
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PART I. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Cardiovascular Systems, Inc.
Consolidated Balance Sheets
(Dollars in Thousands, except per share and share amounts)
(Unaudited)

	March 31, 2011	June 30, 2010
ASSETS		
Current assets		
Cash and cash equivalents	\$ 18,618	\$ 23,717
Accounts receivable, net	13,342	9,394
Inventories	4,865	4,319
Prepaid expenses and other current assets	727	1,048
Total current assets	37,552	38,478
Property and equipment, net	2,220	1,964
Patents, net	2,192	1,712
Debt conversion option and other assets	1,762	568
Total assets	\$ 43,726	\$ 42,722
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Current maturities of long-term debt	\$ 3,723	\$ 2,302
Accounts payable	4,488	3,353
Deferred grant incentive	717	1,181
Accrued expenses	6,519	6,569
Total current liabilities	15,447	13,405
Long-term liabilities		
Long-term debt, net of current maturities	9,598	8,985
Deferred grant incentive	1,741	2,208
Other liabilities	112	409
Total long-term liabilities	11,451	11,602
Total liabilities	26,898	25,007
Commitments and contingencies		
Stockholders' equity		
Common stock, \$0.001 par value; authorized 100,000,000 common shares at March 31, 2011 and June 30, 2010; issued and outstanding 16,154,321 at March 31, 2011 and 15,148,549 at June 30, 2010, respectively	16	15
Additional paid in capital	165,469	157,718
Common stock warrants	11,308	11,305

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Accumulated deficit	(159,965)	(151,323)
Total stockholders' equity	16,828	17,715
Total liabilities and stockholders' equity	\$ 43,726	\$ 42,722

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**Cardiovascular Systems, Inc.**

Consolidated Statements of Operations
(Dollars in thousands, except per share and share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2011	2010	2011	2010
Revenues	\$ 20,152	\$ 16,519	\$ 57,073	\$ 46,814
Cost of goods sold	3,949	3,847	12,063	10,850
Gross profit	16,203	12,672	45,010	35,964
Expenses				
Selling, general and administrative	16,415	16,382	46,597	47,150
Research and development	1,780	2,459	6,316	7,421
Total expenses	18,195	18,841	52,913	54,571
Loss from operations	(1,992)	(6,169)	(7,903)	(18,607)
Interest and other, net	(392)	(349)	(739)	(896)
Net loss	\$ (2,384)	\$ (6,518)	\$ (8,642)	\$ (19,503)
Net loss per common share:				
Basic and Diluted	\$ (0.15)	\$ (0.44)	\$ (0.55)	\$ (1.33)
Weighted average common shares used in computation:				
Basic and Diluted	16,146,667	14,878,859	15,778,287	14,681,014

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**Cardiovascular Systems, Inc.****Consolidated Statements Cash Flows**
(Dollars in thousands)
(Unaudited)

	Nine Months Ended	
	March 31,	
	2011	2010
Cash flows from operating activities		
Net loss	\$ (8,642)	\$ (19,503)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation and amortization of property and equipment	476	399
Provision for doubtful accounts	26	77
Amortization of patents	42	36
Amortization of (premium) discount, net	(7)	216
Debt conversion and valuation of conversion options, net	(415)	
Stock-based compensation	5,221	6,460
Other	250	
Changes in assets and liabilities		
Accounts receivable	(3,974)	(1,404)
Inventories	(546)	(1,193)
Prepaid expenses and other assets	395	77
Accounts payable	1,135	192
Accrued expenses and other liabilities	(1,111)	2,872
Net cash used in operations	(7,150)	(11,771)
Cash flows from investing activities		
Expenditures for property and equipment	(732)	(639)
Sales of investments		3,625
Costs incurred in connection with patents	(522)	(377)
Net cash (used in) provided by investing activities	(1,254)	2,609
Cash flows from financing activities		
Proceeds from employee stock purchase plan	365	702
Payment of deferred financing costs		(50)
Exercise of stock options and warrants	453	285
Proceeds from long-term debt	4,000	4,411
Payments on long-term debt	(1,513)	(6,045)
Net cash provided by (used in) financing activities	3,305	(697)
Net change in cash and cash equivalents	(5,099)	(9,859)
Cash and cash equivalents		

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Beginning of period	23,717	33,411
End of period	\$ 18,618	\$ 23,552

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CARDIOVASCULAR SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(For the nine months ended March 31, 2011 and 2010)
(dollars in thousands, except per share and share amounts)
(unaudited)

1. Business Overview

Company Description and Merger

Cardiovascular Systems, Inc. was incorporated as Replidyne, Inc. in Delaware in 2000. On February 25, 2009, Replidyne, Inc. completed its reverse merger with Cardiovascular Systems, Inc., a Minnesota corporation incorporated in 1989 (CSI-MN), in accordance with the terms of the Agreement and Plan of Merger and Reorganization, dated as of November 3, 2008 (the Merger Agreement). Pursuant to the Merger Agreement, CSI-MN continued after the merger as the surviving corporation and a wholly-owned subsidiary of Replidyne. At the effective time of the merger, Replidyne, Inc. changed its name to Cardiovascular Systems, Inc. (CSI) and CSI-MN merged with and into CSI, with CSI continuing after the merger as the surviving corporation.

The Company develops, manufactures and markets devices for the treatment of vascular diseases. The Company's primary products, the Diamondback 360° PAD System, the Diamondback Predator 360° PAD System, and the Stealth 360° PAD System are catheter-based platforms capable of treating a broad range of plaque types in leg arteries both above and below the knee and address many of the limitations associated with existing treatment alternatives. Prior to the merger, Replidyne was a biopharmaceutical company focused on discovering, developing, in-licensing and commercializing innovative anti-infective products.

2. Summary of Significant Accounting Policies

Interim Financial Statements

The Company has prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America (GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial statements. The year-end consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures as required by accounting principles generally accepted in the United States of America. These interim consolidated financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary to present fairly the Company's consolidated financial position, the results of its operations and its cash flows for the interim periods. These interim consolidated financial statements should be read in conjunction with the consolidated annual financial statements and the notes thereto included in the Form 10-K filed by the Company with the SEC on September 28, 2010. The nature of the Company's business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

Fair Value of Financial Instruments

Effective July 1, 2008, the Company adopted fair value guidance issued by the FASB, which provides a framework for measuring fair value under Generally Accepted Accounting Principles and expands disclosures about fair value measurements. In February 2008, the FASB provided a one-year deferral on the effective date of the guidance for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at least annually.

The fair value guidance classifies inputs into the following hierarchy:

Level 1 Inputs quoted prices in active markets for identical assets and liabilities

Level 2 Inputs observable inputs other than quoted prices in active markets for identical assets and liabilities

Level 3 Inputs unobservable inputs

The following table sets forth the fair value of the Company's financial instruments that were measured on a recurring basis as of March 31, 2011. Assets are measured on a recurring basis if they are remeasured at least annually:

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		Level 3 Conversion Option
Balance at June 30, 2010	\$	388
Issuance of \$4,000 in convertible notes		1,172
Change in conversion option valuation		690
Conversion of \$1,500 convertible note		(594)
Balance at March 31, 2011	\$	1,656

The fair value of the conversion option is related to the loan and security agreement with Partners for Growth (described in Note 4) and has been included in debt conversion option and other assets on the balance sheet. The Monte Carlo option pricing model used to determine the value of the conversion option included various inputs including historical volatility, stock price simulations, and assessed behavior of the Company and Partners for Growth based on those simulations. Based upon these inputs, the Company considers the conversion option to be a Level 3 investment.

As of March 31, 2011, the Company believes that the carrying amounts of its other financial instruments, including accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the short-term maturities of these instruments. The carrying amount of long-term debt approximates fair value based on interest rates currently available for debt with similar terms and maturities.

Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Company sells the majority of its products via direct shipment to hospitals or clinics. The Company recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sales price is fixed or determinable; and collectability is reasonably assured. These criteria are met at the time of delivery when the risk of loss and title passes to the customer. The Company records estimated sales returns, discounts and rebates as a reduction of net sales in the same period revenue is recognized.

Reclassifications

Certain reclassifications have been made to the June 30, 2010 balance sheet to conform to March 31, 2011 presentation. These reclassifications had no effect on net loss or stockholders' equity as previously reported.

3. Selected Consolidated Financial Statement Information***Inventories***

Inventories are stated at the lower of cost or market with cost determined on a first-in, first-out (FIFO) method of valuation. The establishment of inventory allowances for excess and obsolete inventories is based on estimated exposure on specific inventory items.

At March 31, 2011 and June 30, 2010, respectively, inventories were comprised of the following:

	March 31, 2011	June 30, 2010
Inventories		
Raw materials	\$ 1,849	\$ 1,256
Work in process	807	282
Finished goods	2,209	2,781

\$ 4,865 \$ 4,319

Table of Contents**4. Debt*****Loan and Security Agreement with Silicon Valley Bank***

On March 29, 2010, the Company entered into an amended and restated loan and security agreement with Silicon Valley Bank. The agreement includes a \$10,000 term loan and a \$15,000 line of credit. The terms of each of these loans are as follows:

The \$10,000 term loan has a fixed interest rate of 9.0% and a final payment amount equal to 1.0% of the loan amount due at maturity. This term loan has a 36 month maturity, with repayment terms that include interest only payments during the first nine months followed by 30 equal principal and interest payments. This term loan also includes an acceleration provision that requires the Company to pay the entire outstanding balance, plus a penalty ranging from 1.0% to 3.0% of the principal amount, upon prepayment or the occurrence and continuance of an event of default. In connection with entering into the agreement, the Company amended a warrant previously granted to Silicon Valley Bank. The warrant provides an option to purchase 8,493 shares of common stock at an exercise price of \$5.48 per share. This warrant is immediately exercisable and expires ten years after the date of amendment. The balance outstanding on the term loan at March 31, 2011 and June 30, 2010 was \$8,184 and \$9,588, respectively, net of the unamortized discount associated with the warrant.

The \$15,000 line of credit has a two year maturity and a floating interest rate equal to Silicon Valley Bank's prime rate, plus 2.0%, with an interest rate floor of 6.0%. Interest on borrowings is due monthly and the principal balance is due at maturity. Borrowings on the line of credit are based on (a) 80% of eligible domestic receivables, plus (b) the lesser of 40% of eligible inventory or 25% of eligible domestic receivables or \$2,500, minus (c) to the extent in effect, certain loan reserves as defined in the agreement. Accounts receivable receipts are deposited into a lockbox account in the name of Silicon Valley Bank. The accounts receivable line of credit is subject to non-use fees, annual fees, and cancellation fees. The agreement provides that initially 50% of the outstanding principal balance of the \$10,000 term loan reduces available borrowings under the line of credit. Upon the achievement of certain financial covenants, the amount reducing available borrowings will be reduced to zero. There was not an outstanding balance on the line of credit at March 31, 2011 or June 30, 2010.

Borrowings from Silicon Valley Bank are secured by all of the Company's assets. The borrowings are subject to prepayment penalties and financial covenants, including maintaining certain liquidity and fixed charge coverage ratios, and certain three-month EBITDA targets. The Company was in compliance with all financial covenants as of March 31, 2011. The agreement also includes subjective acceleration clauses which permit Silicon Valley Bank to accelerate the due date under certain circumstances, including, but not limited to, material adverse effects on the Company's financial status or otherwise. Any non-compliance by the Company under the terms of debt arrangements could result in an event of default under the Silicon Valley Bank loan, which, if not cured, could result in the acceleration of this debt.

Loan and Security Agreement with Partners for Growth

On April 14, 2010, the Company entered into a loan and security agreement with Partners for Growth III, L.P. (PFG). The agreement provides that PFG will make loans to the Company up to \$4,000. The agreement has a maturity date of April 14, 2015. The loans bear interest at a floating per annum rate equal to 2.75% above Silicon Valley Bank's prime rate, and such interest is payable monthly. The principal balance of and any accrued and unpaid interest on any notes are due on the maturity date and may not be prepaid by the Company at any time in whole or in part.

Under the agreement, PFG provided the Company with an initial loan of \$1,500 (the initial loan) on April 15, 2010. During the three months ended December 31, 2010, PFG at its option converted the entire \$1,500 (at par) into 276,243 shares of the Company's common stock in accordance with the conversion terms set forth in the note for the initial loan. On December 3, 2010, and January 26, 2011, the Company issued PFG additional convertible notes under the agreement of \$3,500 and \$500, respectively (the new loans). At any time prior to the maturity date, PFG may at its option convert any amount of the new loans into shares of the Company's common stock at \$9.66 or

\$12.40 per share, respectively, which equaled the ten-day volume weighted average price per share of the Company's common stock prior to the issuance date of each note. The Company may also effect at any time a mandatory conversion of amounts, subject to certain terms, conditions and limitations provided in the agreement, including a requirement that the ten-day volume weighted average price of the Company's common stock prior to the date of conversion is at least 15% greater than the conversion price. The Company may reduce the conversion price to a price that represents a 15% discount to the ten-day volume weighted average price of its common stock to satisfy this condition and effect a mandatory conversion. As a result of the conversion of the initial loan and the subsequent issuance of the

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new loans the Company has reflected a net (expense) benefit of \$(61) and \$415 for the three and nine months ended March 31, 2011, respectively, in interest and other income (expense) which represents the net effect of (i) the write-off of the conversion option on the initial loan, (ii) the write-off of the unamortized debt premium on the initial loan and (iii) the change in fair value of the conversion options on the new loans.

The loans are secured by certain of the Company's assets, and the agreement contains customary covenants limiting the Company's ability to, among other things, incur debt or liens, make certain investments and loans, effect certain redemptions of and declare and pay certain dividends on its stock, permit or suffer certain change of control transactions, dispose of collateral, or change the nature of its business. In addition, the PFG loan and security agreement contains financial covenants requiring the Company to maintain certain liquidity and fixed charge coverage ratios, and certain three-month EBITDA targets. The Company was in compliance with all financial covenants at March 31, 2011. If the Company does not comply with the various covenants, PFG may, subject to various customary cure rights, decline to provide additional loans, require amortization of the loan over its remaining term, or require the immediate payment of all amounts outstanding under the loan and foreclose on any or all collateral, depending on which financial covenants are not maintained.

In connection with the execution of the PFG loan and security agreement, the Company issued a warrant to PFG on April 14, 2010, which allows PFG to purchase 147,330 shares of the Company's common stock at a price per share of \$5.43, which price was based on the ten-day volume weighted average price per share of the Company's common stock prior to the date of the agreement. The warrant became fully vested upon the issuance of the \$3,500 note. The warrant expires on the fifth anniversary of the issue date, subject to earlier expiration in accordance with the terms. The balance outstanding under the loan and security agreement at March 31, 2011 was \$4,887 including the net unamortized premium associated with the warrant and Company's conversion option.

As of March 31, 2011, debt maturities were as follows:

Three months ending June 30, 2011	\$ 934
2012	3,962
2013	3,589
2014	250
2015	4,000
Total	\$ 12,735
Less: Current Maturities	(3,723)
Long-Term Debt (excluding net unamortized premium)	\$ 9,012
Add: Net Unamortized Premium	586
Long-term debt	\$ 9,598

5. Interest and Other, Net

Interest and other, net, includes the following:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2011	2010	2011	2010
Interest expense, net of premium amortization	\$ (319)	\$ (341)	\$ (1,122)	\$ (1,075)
Interest income	2	58	13	245
Change in fair value of conversion option	(61)		690	
Net write-offs upon conversion (option and unamortized premium)			(275)	
Other	(14)	(66)	(45)	(66)

Total \$ (392) \$ (349) \$ (739) \$ (896)

6. Stock Options and Restricted Stock Awards

The Company has a 2007 Equity Incentive Plan (the 2007 Plan), under which options to purchase common stock and restricted stock awards have been granted to employees, directors and consultants at exercise prices determined by the board of directors; and a 1991 Stock Option Plan (the 1991 Plan) and a 2003 Stock Option Plan (the 2003 Plan) (the 2007 Plan, the 1991 Plan and the 2003 Plan collectively, the Plans). The 1991 Plan and 2003 Plan permitted the granting of incentive stock options and nonqualified

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options. A total of 485,250 shares of common stock were originally reserved for issuance under the 1991 Plan, but with the execution of the 2003 Plan no additional options are available for grant under the 1991 Plan. A total of 2,458,600 shares of common stock were originally reserved for issuance under the 2003 Plan, but with the approval of the 2007 Plan no additional options are available for grant under the 2003 Plan. The 2007 Plan originally allowed for the granting of up to 1,941,000 shares of common stock as approved by the board of directors in the form of nonqualified or incentive stock options, restricted stock awards, restricted stock unit awards, performance share awards, performance unit awards or stock appreciation rights to officers, directors, consultants and employees of the Company. The Plan was amended in February 2009 to increase the number of authorized shares to 2,509,969. The amended 2007 Plan includes a renewal provision whereby the number of shares shall automatically be increased on the first day of each fiscal year ending on July 1, 2017, by the lesser of (i) 970,500 shares, (ii) 5% of the outstanding common shares on such date, or (iii) a lesser amount determined by the board of directors. On July 1, 2010, the number of shares available for grant was increased by 757,427 under the 2007 Plan renewal provision. The Company also maintains the 2006 Equity Incentive Plan (the 2006 Plan), relating to Replidyne activity prior to the merger in February 2009. A total of 794,641 shares were originally reserved under the 2006 Plan, but effective with the merger no additional options will be granted under it.

All options granted under the Plans become exercisable over periods established at the date of grant. The option exercise price is generally based upon the market price for the Company's common stock on the date of grant. In addition, the Company has granted nonqualified stock options to a director outside of the Plans.

Stock option activity for the nine months ended March 31, 2011 is as follows:

	Number of Options(a)	Weighted Average Exercise Price
Options outstanding at June 30, 2010	3,356,993	\$ 10.49
Options exercised	(54,777)	\$ 8.26
Options forfeited or expired	(105,292)	\$ 12.32
Options outstanding at March 31, 2011	3,196,924	\$ 10.47

(a) Includes the effect of options granted, exercised, forfeited or expired from the 1991 Plan, 2003 Plan, 2007 Plan, and options granted outside the stock option plans described above.

Options typically vest over two to three years. An employee's unvested options are forfeited when employment is terminated; vested options must be exercised at or within 90 days of termination to avoid forfeiture. The Company determines the fair value of options using the Black-Scholes option pricing model. The estimated fair value of options, including the effect of estimated forfeitures, is recognized as expense on a straight-line basis over the options' vesting periods.

The fair value of each restricted stock award is equal to the fair market value of the Company's common stock at the date of grant. Vesting of restricted stock awards ranges from one to three years. The estimated fair value of restricted stock awards, including the effect of estimated forfeitures, is recognized on a straight-line basis over the restricted stock's vesting period. Restricted stock award activity for the nine months ended March 31, 2011 is as follows:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards outstanding at June 30, 2010	1,105,883	\$ 7.69

Restricted stock awards granted	712,959	\$	5.36
Restricted stock awards forfeited	(151,524)	\$	7.28
Restricted stock awards vested	(355,203)	\$	6.00
Restricted stock awards outstanding at March 31, 2011	1,312,115	\$	6.22

7. Texas Production Facility

Effective on September 9, 2009, the Company entered into an agreement with the Pearland Economic Development Corporation (the PEDC) for the construction and lease of an approximately 46,000 square foot production facility located in Pearland, Texas. The facility will primarily serve as an additional manufacturing location for the Company.

The lease agreement provides that the PEDC will lease the facility and the land immediately surrounding the facility to the Company for an initial term of ten years, which began April 1, 2010. Monthly fixed rent payments are \$35 for each of the first five

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years of the initial term and \$38 for each of the last five years of the initial term. The Company is also responsible for paying the taxes and operating expenses related to the facility. The lease has been classified as an operating lease for financial statement purposes. Upon an event of default under the agreement, the Company will be liable for the difference between the balance of the rent owed for the remainder of the term and the fair market rental value of the leased premises for such period.

The Company has the option to renew the lease for up to two additional periods of five years each. If the Company elects to exercise one or both of these options, the rent for such extended terms will be set at the prevailing market rental rates at such times, as determined in the agreement. After the commencement date and until shortly before the tenth anniversary of the commencement date, the Company will have the option to purchase all, but not less than all, of the leased premises at fair market value, as determined in the agreement. Further, within six years of the commencement date and subject to certain conditions, the Company has options to cause the PEDC to make two additions or expansions to the facility of a minimum of 34,000 and 45,000 square feet each.

The Company and the PEDC previously entered into a Corporate Job Creation Agreement dated June 17, 2009. The Job Creation Agreement provided the Company with \$2,975 in net cash incentive funds. The Company believes it will be able to comply with the conditions specified in the grant agreement. The PEDC will provide the Company with an additional \$1,700 of net cash incentive funds in the following amounts and upon achievement of the following milestones:

\$1,020, upon the hiring of the 75th full-time employee at the facility; and

\$680, upon the hiring of the 125th full-time employee at the facility.

In order to retain all of the cash incentives, beginning one year and 90 days after the commencement date, the Company must not have fewer than 25 full-time employees at the facility for more than 120 consecutive days. Failure to meet this requirement will result in an obligation to make reimbursement payments to the PEDC as outlined in the agreement. The Company will not have any reimbursement requirements after 60 months from the effective date of the agreement.

The Job Creation Agreement also provides the Company with a net \$1,275 award, of which \$510 will be funded by a grant from the State of Texas for which the Company has applied through the Texas Enterprise Fund program. As of March 31, 2011, \$340 has been received and the remaining \$170 will be provided upon the hiring of the 55th full-time employee at the facility. The PEDC has committed, by resolution, to guarantee the award and will make payment to the Company for the remaining \$765. As of March 31, 2011, \$255 has been received. The grant from the State of Texas is subject to reimbursement if the Company fails to meet certain job creation targets through 2014 and maintain these positions through 2020.

The Company has presented the net cash incentive funds as a current and long-term liability on the balance sheet. The liabilities will be reduced over a 60 month period and recorded as an offset to expenditures incurred using a systematic methodology that is intended to reduce the majority of the liabilities in the first 24 months of the agreement. As of March 31, 2011, \$1,622 in expenses has reduced the deferred grant incentive liabilities, resulting in a remaining current liability of \$717 and long-term liability of \$1,741.

8. Commitment and Contingencies***ev3 Legal Proceedings***

The Company was a party to a legal proceeding with ev3 Inc., ev3 Endovascular, Inc. and FoxHollow Technologies, Inc., together referred to as the Plaintiffs, which filed a complaint on December 28, 2007 in the Ramsey County District Court for the State of Minnesota against the Company and former employees of FoxHollow currently employed by the Company, which complaint was subsequently amended.

On October 27, 2010, the Company entered into a settlement agreement with the Plaintiffs. The agreement dismisses all claims and counterclaims in the legal proceeding between the two parties, with neither party admitting any liability or wrongdoing. Pursuant to the agreement, the Company paid ev3 \$1,000, in the form of \$750 cash and a \$250 promissory note. The promissory note bears interest at 3.5% per annum, with principal and cumulative interest due and payable on or before January 1, 2014. The Company has received insurance proceeds of \$500 related to the settlement, and has recorded a net expense of \$500 in selling, general, and administrative expenses related to the

settlement during the nine months ended March 31, 2011. In addition, during the nine months ended March 31, 2011, the Company received an additional \$250 of insurance proceeds related to the reimbursement of out-of-pocket costs incurred related to this litigation.

Table of Contents**9. Earnings Per Share**

The following table presents a reconciliation of the numerators and denominators used in the basic and diluted earnings per common share computations:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Numerator				
Net loss	\$ (2,384)	\$ (6,518)	\$ (8,642)	\$ (19,503)
Denominator				
Weighted average common shares basic	16,146,667	14,878,859	15,778,287	14,681,014
Effect of dilutive stock options and warrants (a)(b)				
Weighted average common shares outstanding diluted	16,146,667	14,878,859	15,778,287	14,681,014
Net loss per common share basic and diluted	\$ (0.15)	\$ (0.44)	\$ \$ 179,156	
Covered loans	2,596	3,142	7,139	10,742
Investment securities	7,465	7,742	23,489	22,755
Other short-term investments	684	831	2,174	2,474
Total interest income	76,862	72,329	218,555	215,127
Interest Expense				
Deposits	2,806	2,837	7,914	9,160
Borrowed funds	9	390	561	1,217
Senior and subordinated debt	3,016	3,436	9,047	10,306
Total interest expense	5,831	6,663	17,522	20,683
Net interest income	71,031	65,666	201,033	194,444
Provision for loan and covered loan losses	10,727	4,770	17,509	16,257
Net interest income after provision for loan and covered loan losses	60,304	60,896	183,524	178,187
Noninterest Income				
Service charges on deposit accounts	9,902	9,472	26,895	27,267
Wealth management fees	6,721	6,018	19,730	17,983
Card-based fees	6,646	5,509	17,950	16,132
Mortgage banking income	1,125	1,273	3,199	4,251
Other service charges, commissions, and fees	5,266	5,532	13,943	13,937
Gains on sales of properties	3,954	—	3,954	—
Net securities gains	2,570	33,801	8,160	34,017
BOLI income (loss)	767	(13,028)	2,030	(12,428)
Other income	156	1,682	1,748	4,116
Gain on termination of FHLB forward commitments	—	7,829	—	7,829
Loss on extinguishment of debt	—	—	(2,059)	—
Total noninterest income	37,107	58,088	95,550	113,104

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Noninterest Expense				
Salaries and employee benefits	35,933	34,270	103,985	103,760
Net occupancy and equipment expense	8,702	7,982	25,765	23,922
Professional services	7,098	5,517	19,004	16,330
Technology and related costs	4,316	2,984	10,494	8,351
Other expenses	14,264	13,949	39,750	39,580
Total noninterest expense	70,313	64,702	198,998	191,943
Income before income tax expense	27,098	54,282	80,076	99,348
Income tax expense	8,549	24,959	25,363	39,207
Net income	\$ 18,549	\$ 29,323	\$ 54,713	\$ 60,141
Per Common Share Data				
Basic earnings per common share	\$0.25	\$0.39	\$0.73	\$0.80
Diluted earnings per common share	\$0.25	\$0.39	\$0.73	\$0.80
Dividends declared per common share	\$0.08	\$0.04	\$0.23	\$0.09
Weighted-average common shares outstanding	74,341	74,023	74,270	73,969
Weighted-average diluted common shares outstanding	74,352	74,034	74,282	73,978

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)
(Unaudited)

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net income	\$18,549	\$29,323	\$54,713	\$60,141
Securities available-for-sale				
Unrealized holding (losses) gains:				
Before tax	(2,693	) 6,211	22,028	5,359
Tax effect	1,003	(1,993	) (8,776	) (2,151
Net of tax	(1,690	) 4,218	13,252	3,208
Reclassification of net gains included in net income:				
Before tax	2,570	33,801	8,160	34,017
Tax effect	(1,051	) (13,825	) (3,337	) (13,913
Net of tax	1,519	19,976	4,823	20,104
Net unrealized holding (losses) gains	(3,209	) (15,758	) 8,429	(16,896
Derivative instruments				
Unrealized holding losses:				
Before tax	(629	) —	(827) —
Tax effect	257	—	338	—
Net of tax	(372	) —	(489) —
Unrecognized net pension costs				
Unrealized holding gains:				
Before tax	—	—	—	10,997
Tax effect	—	—	—	(4,498
Net of tax	—	—	—	6,499
Total other comprehensive (loss) income	(3,581	) (15,758	) 7,940	(10,397
Total comprehensive income	\$14,968	\$13,565	\$62,653	\$49,744

	Accumulated Unrealized Gain (Loss) on Securities Available- for-Sale	Accumulated Unrealized Loss on Derivative Instruments	Unrecognized Net Pension Costs	Total Accumulated Other Comprehensive Loss
Balance at December 31, 2012	\$1,115	\$—	\$(16,775	) \$(15,660
Other comprehensive (loss) income	(16,896	) —	6,499	(10,397
Balance at September 30, 2013	\$(15,781	) \$—	\$(10,276	) \$(26,057
Balance at December 31, 2013	\$(20,419	) \$—	\$(6,373	) \$(26,792
Other comprehensive income (loss)	8,429	(489	) —	7,940
Balance at September 30, 2014	\$(11,990	) \$(489	) \$(6,373	) \$(18,852

See accompanying notes to the unaudited condensed consolidated financial statements.

FIRST MIDWEST BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Amounts in thousands, except per share data)

(Unaudited)

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at December 31, 2012	74,840	\$858	\$418,318	\$786,453	\$(15,660)	\$(249,076)	\$940,893
Comprehensive income (loss)	—	—	—	60,141	(10,397)	—	49,744
Common dividends declared (\$0.09 per common share)	—	—	—	(6,759)	—	—	(6,759)
Share-based compensation expense	—	—	4,366	—	—	—	4,366
Restricted stock activity	236	—	(9,915)	—	—	8,379	(1,536)
Treasury stock issued to benefit plans	(2)	—	(92)	—	—	109	17
Balance at September 30, 2013	75,074	\$858	\$412,677	\$839,835	\$(26,057)	\$(240,588)	\$986,725
Balance at December 31, 2013	75,071	\$858	\$414,293	\$853,740	\$(26,792)	\$(240,657)	\$1,001,442
Comprehensive income	—	—	—	54,713	7,940	—	62,653
Common dividends declared (\$0.23 per common share)	—	—	—	(17,324)	—	—	(17,324)
Share-based compensation expense	—	—	4,461	—	—	—	4,461
Restricted stock activity	215	—	(9,833)	—	—	7,938	(1,895)
Treasury stock issued to benefit plans	9	—	(132)	—	—	471	339
Balance at September 30, 2014	75,295	\$858	\$408,789	\$891,129	\$(18,852)	\$(232,248)	\$1,049,676

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2014	2013
Net cash provided by operating activities	\$88,575	\$104,383
Investing Activities		
Proceeds from maturities, prepayments, and calls of securities available-for-sale	125,244	178,256
Proceeds from sales of securities available-for-sale	24,947	69,428
Purchases of securities available-for-sale	(16,411	) (326,143
Proceeds from maturities, prepayments, and calls of securities held-to-maturity	3,814	7,084
Purchases of securities held-to-maturity	(1,998	) (2,636
Net (purchases) redemption of FHLB and Federal Reserve Bank stock	(427	) 12,071
Net increase in loans	(291,561	) (233,844
BOLI income, net of claims	(73	) (2
Proceeds from sales of OREO	14,293	20,715
Proceeds from sales of premises, furniture, and equipment	3,893	1,425
Purchases of premises, furniture, and equipment	(7,885	) (6,586
Cash received from acquisitions, net of cash paid	139,486	—
Net cash used in investing activities	(6,678	) (280,232
Financing Activities		
Net increase in deposit accounts	119,440	330,953
Increase in borrowed funds	23,085	26,074
(Payment for) proceeds from the termination of FHLB advances and forward commitments	(116,609	) 7,829
Cash dividends paid	(16,556	) (4,502
Restricted stock activity	(2,739	) (1,588
Excess tax benefit related to share-based compensation	824	55
Net cash provided by financing activities	7,445	358,821
Net increase in cash and cash equivalents	89,342	182,972
Cash and cash equivalents at beginning of period	587,241	716,266
Cash and cash equivalents at end of period	\$676,583	\$899,238
Supplemental Disclosures of Cash Flow Information:		
Income taxes paid (refunded)	\$7,262	\$(1,779
Interest paid to depositors and creditors	14,714	17,715
Dividends declared, but unpaid	6,028	3,006
Non-cash transfers of loans to OREO	13,277	15,877
Non-cash transfer of loans held-for-investment to loans held-for-sale	70,183	1,275
Non-cash transfer of an investment from other assets to securities available-for-sale	—	2,787

See accompanying notes to the unaudited condensed consolidated financial statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

Business Combinations – Business combinations are accounted for under the acquisition method of accounting. Assets acquired and liabilities assumed are recorded at their estimated fair values as of the date of acquisition, with any excess of the purchase price of the acquisition over the fair value of the net tangible and intangible assets acquired recorded as goodwill. Alternatively, a gain is recorded if the fair value of assets purchased exceeds the fair value of liabilities assumed and consideration paid. The results of operations of the acquired business are included in the Consolidated Statements of Income from the effective date of the acquisition.

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

Acquired and Covered Loans - Acquired loans consist primarily of loans that were acquired in business combinations. Covered loans consist of loans acquired by the Company in FDIC-assisted transactions, the majority of which are covered by loss share agreements with the FDIC (the “FDIC Agreements”), under which the FDIC reimburses the

Company for the majority of the losses and eligible expenses related to these assets. No allowance for credit losses is recorded on acquired and covered loans at the acquisition date since business combination accounting requires that they are recorded at fair value.

Acquired and covered loans are separated into (i) non-purchased credit impaired ("Non-PCI") and (ii) purchased credit impaired ("PCI") loans. Non-PCI loans include loans that did not have evidence of credit deterioration since origination. PCI loans include loans that had evidence of credit deterioration since origination and for which it was probable at acquisition that the Company would not collect all contractually required principal and interest payments. Evidence of credit deterioration was evaluated using various indicators, such as past due and non-accrual status. Other key considerations included past performance of the institutions'

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credit underwriting standards, completeness and accuracy of credit files, maintenance of risk ratings, and age of appraisals. Leases and revolving loans do not qualify to be accounted for as PCI loans.

The acquisition adjustment related to Non-PCI loans is amortized into interest income over the contractual life of the related loans. As the acquisition adjustment is accreted into income over future periods, an allowance for credit losses will be established as necessary to reflect credit deterioration.

PCI loans are accounted for prospectively based on estimates of expected future cash flows. To estimate the fair value, the Company generally aggregates purchased consumer loans and certain smaller balance commercial loans into pools of loans with common risk characteristics, such as delinquency status, credit score, and internal risk rating. The fair values of larger balance commercial loans are estimated on an individual basis. Expected future cash flows in excess of the fair value of loans at the purchase date (“accretable yield”) are recorded as interest income over the life of the loans if the timing and amount of the expected future cash flows can be reasonably estimated. The non-accretable yield represents the difference between contractually required payments and the expected future cash flows determined at acquisition. Subsequent increases in expected future cash flows are recognized as interest income prospectively. The present value of any decreases in expected future cash flows is recognized by recording a charge-off through the allowance for loan and covered loan losses or establishing an allowance for loan and covered loan losses.

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

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

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

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

The Company does not accrue interest on a TDR unless it believes collection of all principal and interest under the modified terms is reasonably assured. For a TDR to begin accruing interest, the borrower must demonstrate both some

level of past performance and the future capacity to perform under the modified terms. Generally, six months of consecutive payment performance under the restructured terms is required before a TDR is returned to accrual status. However, the period could vary depending on the individual facts and circumstances of the loan. An evaluation of the borrower's current creditworthiness is used to assess the borrower's capacity to repay the loan under the modified terms. This evaluation includes an estimate of expected future cash flows, evidence of strong financial position, and estimates of the value of collateral, if applicable. For TDRs to be removed from TDR status in the calendar year after the restructuring, the loans must (i) have an interest rate and terms that reflect market conditions at the time of restructuring, and (ii) be in compliance with the modified terms. If the loan was restructured at below market rates and terms, it continues to be separately reported as restructured until it is paid in full or charged-off.

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

A loan is considered impaired when it is probable that the Company will not collect all contractual principal and interest. With the exception of accruing TDRs, impaired loans are classified as non-accrual and are exclusive of smaller homogeneous loans, such as home equity, 1-4 family mortgages, and installment loans. Impaired loans with balances under a specified threshold are not individually evaluated for impairment. For all other impaired loans, impairment is measured by comparing the estimated value

of the loan to the recorded book value. The value of collateral-dependent loans is based on the fair value of the underlying collateral, less costs to sell. The value of other loans is measured using the present value of expected future cash flows discounted at the loan's initial effective interest rate.

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

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

Loans deemed to be uncollectible are charged-off against the allowance for loan and covered loan losses, while recoveries of amounts previously charged-off are credited to the allowance for loan and covered loan losses. Additions to the allowance for loan and covered loan losses are charged to expense through the provision for loan and covered loan losses. The amount of provision depends on a number of factors, including net charge-off levels, loan growth, changes in the composition of the loan portfolio, and the Company's assessment of the allowance for loan and covered loan losses based on the methodology discussed below.

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

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

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

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

Allowance for Covered Loan Losses – The Company's allowance for covered loan losses reflects the difference between the carrying value and the expected future cash flows of the covered PCI loans. On a periodic basis, the adequacy of

this allowance is determined through a re-estimation of expected future cash flows on all of the outstanding covered PCI loans using either a probability of default/loss given default (“PD/LGD”) methodology or a specific review methodology. The PD/LGD model is a loss model that estimates expected future cash flows using a probability of default curve and loss given default estimates.

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

The establishment of the allowance for credit losses involves a high degree of judgment given the difficulty of assessing the factors impacting loan repayment and estimating the timing and amount of losses. While management utilizes its best judgment and information available, the adequacy of the allowance for credit losses depends on a variety of factors beyond the Company’s

control, including the performance of its loan portfolio, the economy, changes in interest rates and property values, and the interpretation of loan risk classifications by regulatory authorities.

FDIC Indemnification Asset – The majority of loans and OREO acquired through FDIC-assisted transactions are covered by the FDIC Agreements. The FDIC indemnification asset represents the present value of future expected reimbursements from the FDIC. Since the indemnified items are covered loans and covered OREO, which are initially measured at fair value, the FDIC indemnification asset is also initially measured at fair value by discounting the expected future cash flows to be received from the FDIC. These expected future cash flows are estimated by multiplying estimated losses on covered PCI loans and covered OREO by the reimbursement rates in the FDIC Agreements.

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

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

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

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

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

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

2. RECENT EVENTS

Equity Matters

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

Recent Accounting Pronouncements

Income Taxes: In January of 2014, the Financial Accounting Standards Board ("FASB") issued guidance that requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net

operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date or, if the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The guidance is effective for annual and interim reporting periods beginning on or after December 15, 2013, and must be applied prospectively. The adoption of this guidance on January 1, 2014 did not impact the Company's financial condition, results of operations, or liquidity.

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

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

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

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

Receivables - Troubled Debt Restructurings by Creditors: In August of 2014, the FASB issued guidance that requires an entity to derecognize a mortgage loan and recognize a separate other receivable upon foreclosure if (i) the loan has a government guarantee that is not separable from the loan before foreclosure, (ii) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on that guarantee, and the creditor has the ability to recover under that claim, and (iii) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. The separate other receivable is to be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The guidance is effective for annual and interim reporting periods beginning after December 15, 2014. Management is evaluating the new guidance, but does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern: In August of 2014, the FASB issued guidance that requires management to evaluate whether there are conditions or events, considered in the

aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. The guidance is effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

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3. ACQUISITIONS

Completed Acquisitions

Popular Community Bank

On August 8, 2014, First Midwest Bank (the "Bank") completed the acquisition of the Chicago area banking operations of Banco Popular North America ("Popular"), doing business as Popular Community Bank, which is a subsidiary of Popular, Inc. The acquisition included Popular's twelve full-service retail banking offices and its small business and middle market commercial lending activities in the Chicago metropolitan area at a purchase price of \$19.0 million paid in cash.

The assets acquired and liabilities assumed, both intangible and tangible, were recorded at their estimated fair values as of the August 8, 2014 acquisition date and have been accounted for under the acquisition method of accounting. The Company is finalizing the fair values of loans and intangible assets and liabilities. As a result, the fair value adjustments associated with these accounts and goodwill, which are included in the following table, are preliminary and may change.

Popular Acquisition

(Dollar amounts in thousands)

	August 8, 2014
Assets	
Cash and due from banks	\$ 142,276
Loans:	
Commercial, industrial, and agricultural	76,680
Commercial real estate:	
Office, retail, and industrial	194,312
Multi-family	192,464
Other commercial real estate	57,111
Total commercial real estate	443,887
Consumer	28,819
Total loans	549,386
Goodwill	36,906
Intangible assets	8,003
Premises, furniture, and equipment	4,647
Accrued interest receivable and other assets	1,849
Total assets	\$ 743,067
Liabilities	
Deposits:	
Demand deposits	\$ 163,299
Savings deposits	91,205
NOW accounts	100,852
Money market deposits	181,730
Time deposits	194,786
Total deposits	731,872
Intangible liabilities	10,631
Accrued interest payable and other liabilities	564
Total liabilities	\$ 743,067

Expenses related to the acquisition of Popular totaled \$2.2 million and \$2.8 million during the quarter and nine months ended September 30, 2014, respectively, and are reported within noninterest expense. The acquisition was not considered material to the Company's financial statements; therefore, pro forma financial data and related disclosures are not included.

National Machine Tool Financial Corporation

On September 26, 2014, the Bank completed the acquisition of National Machine Tool Financial Corporation ("National Machine Tool"). National Machine Tool provides equipment leasing and financing alternatives to traditional bank financing. On the date of acquisition, the Bank acquired approximately \$4.4 million in direct financing leases, lease loans, and other assets.

Pending Acquisitions

Great Lakes Financial Resources, Inc.

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

4. SECURITIES

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

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

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

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

Securities Portfolio

(Dollar amounts in thousands)

	September 30, 2014				December 31, 2013			
	Amortized Cost	Gross Gains	Unrealized Losses	Fair Value	Amortized Cost	Gross Gains	Unrealized Losses	Fair Value
Securities Available-for-Sale								
U.S. agency securities	\$500	\$—	\$—	\$500	\$500	\$—	\$—	\$500
Collateralized mortgage obligations (“CMOs”)	424,946	1,578	(9,977)	416,547	490,962	1,427	(16,621)	475,768
Other mortgage-backed securities (“MBSs”)	117,271	4,045	(827)	120,489	135,097	3,349	(2,282)	136,164
Municipal securities	423,904	12,517	(1,349)	435,072	457,318	9,673	(5,598)	461,393
Trust preferred collateralized debt obligations (“CDOs”)	45,021	—	(26,652)	18,369	46,532	—	(28,223)	18,309
Corporate debt securities	3,724	122	—	3,846	12,999	1,930	—	14,929
Equity securities	2,575	77	(55)	2,597	3,706	2,046	(90)	5,662
Total available-for-sale securities	\$1,017,941	\$18,339	\$(38,860)	\$997,420	\$1,147,114	\$18,425	\$(52,814)	\$1,112,725
Securities Held-to-Maturity								
Municipal securities	\$26,776	\$990	\$—	\$27,766	\$44,322	\$—	\$(935)	\$43,387
Trading Securities				\$17,928				\$17,317

Remaining Contractual Maturity of Securities

(Dollar amounts in thousands)

	September 30, 2014		Held-to-Maturity	
	Available-for-Sale Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	\$65,157	\$63,042	\$3,425	\$3,552
After one year to five years	80,964	78,335	8,505	8,819
After five years to ten years	196,380	190,004	5,703	5,914
After ten years	130,648	126,406	9,143	9,481
Securities that do not have a single contractual maturity date	544,792	539,633	—	—
Total	\$1,017,941	\$997,420	\$26,776	\$27,766

The carrying value of securities available-for-sale that were pledged to secure deposits or for other purposes as permitted or required by law totaled \$816.1 million at September 30, 2014 and \$755.3 million at December 31, 2013. No securities held-to-maturity were pledged as of September 30, 2014 or December 31, 2013.

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

Securities Gains (Losses)
(Dollar amounts in thousands)

	Quarters Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Gains on sales of securities:				
Gross realized gains	\$2,570	\$34,205	\$8,188	\$34,421
Gross realized losses	—	—	—	—
Net realized gains on sales of securities	2,570	34,205	8,188	34,421
Non-cash impairment charges:				
Other-than-temporary securities impairment ("OTTI")	—	(404	) (28	) (404
Net non-cash impairment charges	—	(404	) (28	) (404
Net realized gains	\$2,570	\$33,801	\$8,160	\$34,017
Net trading (losses) gains ⁽¹⁾	\$(356	) \$882	\$366	\$2,132

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

Net realized gains on sales of securities for the third quarter and first nine months of 2014 were \$2.6 million and \$8.2 million, respectively. During the third quarter of 2014, the Company sold certain corporate bonds and other investments at gains of \$2.6 million. Net securities gains for the nine months ended September 30, 2014 also consisted of the sale of a non-accrual CDO at a gain of \$3.5 million, sales of municipal securities at gains of \$468,000, and the sale of other investments at a gain of \$1.6 million.

The non-cash impairment charges for the nine months ended September 30, 2014 in the table above relates to OTTI charges on certain CMOs. For the quarter and nine months ended September 30, 2013, non-cash impairment charges relates to OTTI on municipal securities and CDOs. Accounting guidance requires that the credit portion of an OTTI charge be recognized through income. If a decline in fair value below carrying value is not attributable to credit deterioration and the Company does not intend to sell the security or believe it would not be more likely than not required to sell the security prior to recovery, the Company records the non-credit related portion of the decline in fair value in other comprehensive (loss) income.

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

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

	Quarters Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Beginning balance	\$23,880	\$32,053	\$32,422	\$38,803
OTTI included in earnings ⁽¹⁾ :				
Losses on securities that previously had OTTI	—	—	28	—
Losses on securities that did not previously have OTTI	—	404	—	404
Reduction for sales of securities ⁽²⁾	—	(39) (8,570) (6,789

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Ending balance	\$23,880	\$32,418	\$23,880	\$32,418
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(1) Included in net securities gains in the Condensed Consolidated Statements of Income.

During the nine months ended September 30, 2014, one CDO with a carrying value of \$1.3 million was sold. In

(2) addition, one CDO with a carrying value of zero was sold during the nine months ended September 30, 2013.

These CDOs had OTTI of \$8.6 million and \$6.8 million, respectively, that were previously recognized in earnings.

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

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

	Number of Securities	Less Than 12 Months		Greater Than 12 Months		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
As of September 30, 2014							
CMOs	59	\$15,653	\$139	\$312,418	\$9,838	\$328,071	\$9,977
Other MBSs	11	173	2	41,570	825	41,743	827
Municipal securities	92	1,318	8	57,298	1,341	58,616	1,349
CDOs	5	—	—	18,369	26,652	18,369	26,652
Equity securities	1	—	—	2,238	55	2,238	55
Total	168	\$17,144	\$149	\$431,893	\$38,711	\$449,037	\$38,860
As of December 31, 2013							
CMOs	67	\$338,064	\$14,288	\$57,269	\$2,333	\$395,333	\$16,621
Other MBSs	19	57,311	2,281	356	1	57,667	2,282
Municipal securities	154	65,370	3,245	27,565	2,353	92,935	5,598
CDOs	6	—	—	18,309	28,223	18,309	28,223
Equity securities	1	2,168	90	—	—	2,168	90
Total	247	\$462,913	\$19,904	\$103,499	\$32,910	\$566,412	\$52,814

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

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

Significant judgment is required to calculate the fair value of the CDOs, all of which are pooled. The Company estimates the fair value of these securities using discounted cash flow analyses with the assistance of a structured credit valuation firm. For additional discussion of the CDO valuation methodology, refer to Note 12, "Fair Value."

5. LOANS

Loans Held-for-Investment

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

Loan Portfolio

(Dollar amounts in thousands)

	September 30, 2014	December 31, 2013
Commercial and industrial	\$2,208,166	\$1,830,638
Agricultural	347,511	321,702
Commercial real estate:		
Office, retail, and industrial	1,422,522	1,353,685
Multi-family	559,689	332,873
Construction	193,445	186,197
Other commercial real estate	871,825	807,071
Total commercial real estate	3,047,481	2,679,826
Total corporate loans	5,603,158	4,832,166
Home equity	517,446	427,020
1-4 family mortgages	238,172	275,992
Installment	69,428	44,827
Total consumer loans	825,046	747,839
Total loans, excluding covered loans	6,428,204	5,580,005
Covered loans ⁽¹⁾	90,875	134,355
Total loans	\$6,519,079	\$5,714,360
Deferred loan fees included in total loans	\$4,163	\$4,656
Overdrawn demand deposits included in total loans	3,632	5,047

⁽¹⁾ For information on covered loans, refer to Note 6, "Acquired and Covered Loans."

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

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

Loan Sales

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

Loan Sales

(Dollar amounts in thousands)

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
1-4 family mortgage loans				
Proceeds from sales	\$32,611	\$37,060	\$117,549	\$122,067
Less book value of loans sold:				
Loans originated with intent to sell	26,384	32,485	62,319	32,807
Loans held-for-investment	5,302	3,592	52,384	85,271
Total book value of loans sold	31,686	36,077	114,703	118,078
Net gains on sales of 1-4 family mortgages	\$925	\$983	\$2,846	\$3,989

The Company retained servicing responsibilities for a portion of the 1-4 family mortgage loans sold and collects servicing fees equal to a percentage of the outstanding principal balance. The Company also retained limited recourse for credit losses on the sold loans. A description of the recourse obligation is presented in Note 11, "Commitments, Guarantees, and Contingent Liabilities."

6. ACQUIRED AND COVERED LOANS

Acquired loans consist primarily of loans that were acquired in business combinations that are not covered by the FDIC Agreements. These loans are included in loans, excluding covered loans, in the Consolidated Statements of Financial Condition. Covered loans consist of loans acquired by the Company in four FDIC-assisted transactions. Most loans and OREO acquired in three of those transactions are covered by the FDIC Agreements. The significant accounting policies related to acquired and covered loans, which are classified as PCI and Non-PCI, and the related FDIC indemnification asset are presented in Note 1, "Summary of Significant Accounting Policies."

The following table presents PCI and Non-PCI, loans as of September 30, 2014 and December 31, 2013.

Acquired and Covered Loans
(Dollar amounts in thousands)

	September 30, 2014			December 31, 2013		
	PCI	Non-PCI	Total	PCI	Non-PCI	Total
Acquired loans	\$20,937	\$539,454	\$560,391	\$15,608	\$17,024	\$32,632
Covered loans	64,015	26,860	90,875	103,525	30,830	134,355
Total acquired and covered loans	\$84,952	\$566,314	\$651,266	\$119,133	\$47,854	\$166,987

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

A rollforward of the carrying value of the FDIC indemnification asset for the quarters and nine months ended September 30, 2014 and 2013 is presented in the following table.

Changes in the FDIC Indemnification Asset
(Dollar amounts in thousands)

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Beginning balance	\$10,276	\$23,158	\$16,585	\$37,051
Amortization	(650)	(116)	(2,784)	(2,348)
Change in expected reimbursements from the FDIC for changes in expected credit losses	(857)	(999)	(325)	(3,453)
Payments received from the FDIC	(70)	(3,965)	(4,777)	(13,172)
Ending balance	\$8,699	\$18,078	\$8,699	\$18,078

Changes in the accretable yield for acquired and covered PCI loans were as follows.

Changes in Accretable Yield
(Dollar amounts in thousands)

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Beginning balances	\$35,152	\$47,104	\$36,792	\$51,498
Accretion	(3,346	) (3,410	) (10,277	) (11,752
Additions	1,265	—	1,265	—
Other ⁽¹⁾	(5,215	) (3,128	) 76	820
Ending balance	\$27,856	\$40,566	\$27,856	\$40,566

Decreases result from the resolution of certain loans occurring earlier than anticipated while increases represent an ⁽¹⁾ increase in the expected future cash flows to be collected over the remaining estimated life of the underlying portfolio.

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

Past Due and Non-accrual Loans

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

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

	Aging Analysis (Accruing and Non-accrual)				Non-performing Loans		
	Current	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Total Loans	Non-accrual Loans	90 Days Past Due Loans, Still Accruing Interest
September 30, 2014							
Commercial and industrial	\$2,197,785	\$6,216	\$4,165	\$10,381	\$2,208,166	\$19,696	\$1,256
Agricultural	347,179	—	332	332	347,511	361	—
Commercial real estate:							
Office, retail, and industrial	1,401,990	1,842	18,690	20,532	1,422,522	16,963	3,840
Multi-family	557,852	641	1,196	1,837	559,689	1,536	—
Construction	186,363	—	7,082	7,082	193,445	7,082	—
Other commercial real estate	861,061	4,461	6,303	10,764	871,825	7,912	150
Total commercial real estate	3,007,266	6,944	33,271	40,215	3,047,481	33,493	3,990
Total corporate loans	5,552,230	13,160	37,768	50,928	5,603,158	53,550	5,246
Home equity	509,530	3,525	4,391	7,916	517,446	5,834	587
1-4 family mortgages	234,672	1,935	1,565	3,500	238,172	3,235	126
Installment	66,997	428	2,003	2,431	69,428	1,909	103
Total consumer loans	811,199	5,888	7,959	13,847	825,046	10,978	816
Total loans, excluding covered loans	6,363,429	19,048	45,727	64,775	6,428,204	64,528	6,062
Covered loans	73,370	954	16,551	17,505	90,875	10,905	7,031
Total loans	\$6,436,799	\$20,002	\$62,278	\$82,280	\$6,519,079	\$75,433	\$13,093
December 31, 2013							
Commercial and industrial	\$1,814,660	\$6,872	\$9,106	\$15,978	\$1,830,638	\$11,767	\$393
Agricultural	321,156	134	412	546	321,702	519	—
Commercial real estate:							
Office, retail, and industrial	1,335,027	2,620	16,038	18,658	1,353,685	17,076	1,315
Multi-family	330,960	318	1,595	1,913	332,873	1,848	—
Construction	180,083	23	6,091	6,114	186,197	6,297	—
Other commercial real estate	795,462	5,365	6,244	11,609	807,071	8,153	258
Total commercial real estate	2,641,532	8,326	29,968	38,294	2,679,826	33,374	1,573
Total corporate loans	4,777,348	15,332	39,486	54,818	4,832,166	45,660	1,966

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

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Allowance for Credit Losses

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

Allowance for Credit Losses by Portfolio Segment

(Dollar amounts in thousands)

	Commercial Industrial, and Agricultural	Office, Retail, and Industrial	Multi- Family	Construction	Other Commercial Real Estate	Consumer	Covered Loans	Reserve for Unfunded Commitments	Total Allowance
Quarter ended									
September 30, 2014									
Beginning balance	\$ 29,194	\$ 11,831	\$ 2,048	\$ 4,885	\$ 8,585	\$ 12,440	\$ 9,343	\$ 1,616	\$ 79,942
Charge-offs	(9,763)	(2,514)	(26)	(157)	(1,363)	(3,148)	(135)	—	(17,106)
Recoveries	716	55	—	—	108	150	130	—	1,159
Net charge-offs	(9,047)	(2,459)	(26)	(157)	(1,255)	(2,998)	(5)	—	(15,947)
Provision for loan and covered loan losses and other	10,458	265	(65)	(3,130)	189	3,699	(689)	—	10,727
Ending balance	\$ 30,605	\$ 9,637	\$ 1,957	\$ 1,598	\$ 7,519	\$ 13,141	\$ 8,649	\$ 1,616	\$ 74,722
Quarter ended									
September 30, 2013									
Beginning balance	\$ 31,742	\$ 11,857	\$ 3,424	\$ 4,170	\$ 16,169	\$ 12,367	\$ 14,381	\$ 2,866	\$ 96,976
Charge-offs	(2,719)	(987)	(112)	(470)	(889)	(2,482)	(1,636)	—	(9,295)
Recoveries	521	31	—	57	253	374	7	—	1,243
Net charge-offs	(2,198)	(956)	(112)	(413)	(636)	(2,108)	(1,629)	—	(8,052)
Provision for loan and covered loan losses and other	2,452	938	(31)	(100)	(1,218)	2,425	304	(480)	4,290
Ending balance	\$ 31,996	\$ 11,839	\$ 3,281	\$ 3,657	\$ 14,315	\$ 12,684	\$ 13,056	\$ 2,386	\$ 93,214
Nine months ended September 30,									
2014									
Beginning balance	\$ 30,381	\$ 10,405	\$ 2,017	\$ 6,316	\$ 10,817	\$ 13,010	\$ 12,559	\$ 1,616	\$ 87,121
Charge-offs	(15,542)	(7,108)	(383)	(1,052)	(3,695)	(7,005)	(659)	—	(35,444)
Recoveries	3,135	403	3	160	341	502	992	—	5,536
Net charge-offs	(12,407)	(6,705)	(380)	(892)	(3,354)	(6,503)	333	—	(29,908)
Provision for loan	12,631	5,937	320	(3,826)	56	6,634	(4,243)	—	17,509

and covered loan losses and other										
Ending balance	\$ 30,605	\$ 9,637	\$ 1,957	\$ 1,598	\$ 7,519	\$ 13,141	\$ 8,649	\$ 1,616	\$ 74,722	
Nine months ended September 30, 2013										
Beginning balance	\$ 36,761	\$ 11,432	\$ 3,575	\$ 5,242	\$ 17,512	\$ 12,862	\$ 12,062	\$ 3,366	\$ 102,812	
Charge-offs	(9,010)	(3,702)	(490)	(1,885)	(3,971)	(7,369)	(4,322)	—	(30,749)	
Recoveries	3,183	68	35	62	1,614	894	18	—	5,874	
Net charge-offs	(5,827)	(3,634)	(455)	(1,823)	(2,357)	(6,475)	(4,304)	—	(24,875)	
Provision for loan and covered loan losses and other	1,062	4,041	161	238	(840)	6,297	5,298	(980)	15,277	
Ending balance	\$ 31,996	\$ 11,839	\$ 3,281	\$ 3,657	\$ 14,315	\$ 12,684	\$ 13,056	\$ 2,386	\$ 93,214	

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

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

	Loans		PCI	Total	Allowance for Credit Losses			Total
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment			Individually Evaluated for Impairment	Collectively Evaluated for Impairment	PCI	
September 30, 2014								
Commercial, industrial, and agricultural	\$ 18,547	\$ 2,535,395	\$ 1,735	\$ 2,555,677	\$ 3,599	\$ 27,006	\$—	\$ 30,605
Commercial real estate:								
Office, retail, and industrial	16,140	1,406,307	75	1,422,522	—	9,637	—	9,637
Multi-family	1,141	554,814	3,734	559,689	—	1,942	15	1,957
Construction	6,859	186,586	—	193,445	—	1,598	—	1,598
Other commercial real estate	4,719	860,410	6,696	871,825	—	7,519	—	7,519
Total commercial real estate	28,859	3,008,117	10,505	3,047,481	—	20,696	15	20,711
Total corporate loans	47,406	5,543,512	12,240	5,603,158	3,599	47,702	15	51,316
Consumer	—	816,349	8,697	825,046	—	12,588	553	13,141
Total loans, excluding covered loans	47,406	6,359,861	20,937	6,428,204	3,599	60,290	568	64,457
Covered loans	—	26,860	64,015	90,875	—	578	8,071	8,649
Reserve for unfunded commitments	—	—	—	—	—	1,616	—	1,616
Total loans	\$ 47,406	\$ 6,386,721	\$ 84,952	\$ 6,519,079	\$ 3,599	\$ 62,484	\$ 8,639	\$ 74,722
December 31, 2013								
Commercial, industrial, and agricultural	\$ 13,178	\$ 2,137,440	\$ 1,722	\$ 2,152,340	\$ 4,046	\$ 26,335	\$—	\$ 30,381
Commercial real estate:								
Office, retail, and industrial	26,348	1,327,337	—	1,353,685	214	10,191	—	10,405
Multi-family	1,296	331,445	132	332,873	18	1,999	—	2,017
Construction	5,712	180,485	—	186,197	178	6,138	—	6,316
Other commercial real estate	9,298	793,703	4,070	807,071	704	10,113	—	10,817
Total commercial real estate	42,654	2,632,970	4,202	2,679,826	1,114	28,441	—	29,555
Total corporate loans	55,832	4,770,410	5,924	4,832,166	5,160	54,776	—	59,936
Consumer	—	738,155	9,684	747,839	—	13,010	—	13,010
Total loans, excluding covered loans	55,832	5,508,565	15,608	5,580,005	5,160	67,786	—	72,946

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Covered loans	—	30,830	103,525	134,355	—	702	11,857	12,559
Reserve for unfunded commitments	—	—	—	—	—	1,616	—	1,616
Total loans	\$55,832	\$5,539,395	\$119,133	\$5,714,360	\$5,160	\$70,104	\$11,857	\$87,121

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Loans Individually Evaluated for Impairment

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

Impaired Loans Individually Evaluated by Class

(Dollar amounts in thousands)

	September 30, 2014 Recorded Investment In				December 31, 2013 Recorded Investment In			
	Loans with No Specific Reserve	Loans with a Specific Reserve	Unpaid Principal Balance	Specific Reserve	Loans with No Specific Reserve	Loans with a Specific Reserve	Unpaid Principal Balance	Specific Reserve
Commercial and industrial	\$2,524	\$16,023	\$40,067	\$2,968	\$10,047	\$3,131	\$25,887	\$4,046
Agricultural	—	—	—	—	—	—	—	—
Commercial real estate:								
Office, retail, and industrial	16,140	—	25,614	—	23,872	2,476	35,868	214
Multi-family	1,141	—	1,268	—	1,098	198	1,621	18
Construction	6,859	—	8,412	—	4,586	1,126	10,037	178
Other commercial real estate	4,719	—	6,979	—	7,553	1,745	11,335	704
Total commercial real estate	28,859	—	42,273	—	37,109	5,545	58,861	1,114
Total impaired loans individually evaluated for impairment	\$31,383	\$16,023	\$82,340	\$2,968	\$47,156	\$8,676	\$84,748	\$5,160

The following table presents the average recorded investment and interest income recognized on impaired loans by class for the quarters and nine months ended September 30, 2014 and 2013. PCI loans are excluded from this disclosure.

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

	Quarters Ended September 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized ⁽¹⁾	Average Recorded Investment	Interest Income Recognized ⁽¹⁾
Commercial and industrial	\$20,137	\$57	\$20,665	\$195
Agricultural	—	—	—	—
Commercial real estate:				
Office, retail, and industrial	15,873	3	25,747	5
Multi-family	1,155	—	1,337	—
Construction	5,792	—	6,511	—
Other commercial real estate	5,234	22	12,511	16
Total commercial real estate	28,054	25	46,106	21
Total impaired loans	\$48,191	\$82	\$66,771	\$216
	Nine Months Ended September 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized ⁽¹⁾	Average Recorded Investment	Interest Income Recognized ⁽¹⁾
Commercial and industrial	\$15,222	\$204	\$22,862	\$198
Agricultural	—	—	—	—
Commercial real estate:				
Office, retail, and industrial	20,671	150	24,415	15
Multi-family	1,321	—	1,071	—
Construction	5,537	—	5,987	—
Other commercial real estate	6,701	137	14,102	24
Total commercial real estate	34,230	287	45,575	39
Total impaired loans	\$49,452	\$491	\$68,437	\$237

⁽¹⁾ Recorded using the cash basis of accounting.

Credit Quality Indicators

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

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

	Pass	Special Mention ^{(1) (4)}	Substandard ⁽²⁾ ⁽⁴⁾	Non-accrual ⁽³⁾	Total
September 30, 2014					
Commercial and industrial	\$2,094,453	\$66,429	\$27,588	\$19,696	\$2,208,166
Agricultural	346,851	299	—	361	347,511
Commercial real estate:					
Office, retail, and industrial	1,343,833	28,586	33,140	16,963	1,422,522
Multi-family	545,419	5,916	6,818	1,536	559,689
Construction	162,527	7,229	16,607	7,082	193,445
Other commercial real estate	816,679	22,824	24,410	7,912	871,825
Total commercial real estate	2,868,458	64,555	80,975	33,493	3,047,481
Total corporate loans	\$5,309,762	\$131,283	\$108,563	\$53,550	\$5,603,158
December 31, 2013					
Commercial and industrial	\$1,780,194	\$23,806	\$14,871	\$11,767	\$1,830,638
Agricultural	320,839	344	—	519	321,702
Commercial real estate:					
Office, retail, and industrial	1,284,394	28,677	23,538	17,076	1,353,685
Multi-family	326,901	3,214	910	1,848	332,873
Construction	153,949	8,309	17,642	6,297	186,197
Other commercial real estate	761,465	14,877	22,576	8,153	807,071
Total commercial real estate	2,526,709	55,077	64,666	33,374	2,679,826
Total corporate loans	\$4,627,742	\$79,227	\$79,537	\$45,660	\$4,832,166

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

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

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

(4) Total special mention and substandard loans includes accruing TDRs of \$3.5 million as of September 30, 2014 and \$2.8 million as of December 31, 2013.

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

	Performing	Non-accrual	Total
September 30, 2014			
Home equity	\$511,612	\$5,834	\$517,446
1-4 family mortgages	234,937	3,235	238,172
Installment	67,519	1,909	69,428
Total consumer loans	\$814,068	\$10,978	\$825,046
December 31, 2013			
Home equity	\$420,156	\$6,864	\$427,020
1-4 family mortgages	270,794	5,198	275,992
Installment	42,751	2,076	44,827
Total consumer loans	\$733,701	\$14,138	\$747,839

TDRs

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

TDRs by Class

(Dollar amounts in thousands)

	As of September 30, 2014			As of December 31, 2013		
	Accruing	Non-accrual ⁽¹⁾	Total	Accruing	Non-accrual ⁽¹⁾	Total
Commercial and industrial	\$2,163	\$15,806	\$17,969	\$6,538	\$2,121	\$8,659
Agricultural	—	—	—	—	—	—
Commercial real estate:						
Office, retail, and industrial	592	—	592	10,271	—	10,271
Multi-family	616	237	853	1,038	253	1,291
Construction	—	—	—	—	—	—
Other commercial real estate	441	186	627	4,326	291	4,617
Total commercial real estate	1,649	423	2,072	15,635	544	16,179
Total corporate loans	3,812	16,229	20,041	22,173	2,665	24,838
Home equity	752	513	1,265	787	512	1,299
1-4 family mortgages	885	235	1,120	810	906	1,716
Installment	—	—	—	—	—	—
Total consumer loans	1,637	748	2,385	1,597	1,418	3,015
Total loans	\$5,449	\$16,977	\$22,426	\$23,770	\$4,083	\$27,853

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

TDRs are included in the calculation of the allowance for credit losses in the same manner as impaired loans. There were \$2.6 million in specific reserves related to TDRs as of September 30, 2014 and there were \$2.0 million in specific reserves related to TDRs as of December 31, 2013.

The following table presents a summary of loans that were restructured during the quarters and nine months ended September 30, 2014 and 2013.

Loans Restructured During the Period
(Dollar amounts in thousands)

	Number of Loans	Pre- Modification Recorded Investment	Funds Disbursed	Interest and Escrow Capitalized	Charge-offs	Post- Modification Recorded Investment
Quarter ended September 30, 2014						
Commercial and industrial	5	\$23,015	\$—	\$—	\$—	\$23,015
Office, retail, and industrial	1	417	—	—	—	417
Total TDRs restructured during the period	6	\$23,432	\$—	\$—	\$—	\$23,432
Quarter ended September 30, 2013						
Commercial and industrial	3	\$369	\$—	\$—	\$—	\$369
Office, retail, and industrial	2	1,674	—	—	—	1,674
Other commercial real estate	1	10	—	—	—	10
Home equity	8	822	—	—	—	822
Total TDRs restructured during the period	14	\$2,875	\$—	\$—	\$—	\$2,875
Nine months ended September 30, 2014						
Commercial and industrial	5	\$23,015	\$—	\$—	\$—	\$23,015
Office, retail, and industrial	1	417	—	—	—	417
Home equity	1	75	—	—	—	75
Total TDRs restructured during the period	7	\$23,507	\$—	\$—	\$—	\$23,507
Nine months ended September 30, 2013						
Commercial and industrial	7	\$14,439	\$—	\$2	\$—	\$14,441
Office, retail, and industrial	6	2,275	30	—	—	2,305
Multi-family	5	1,275	—	57	—	1,332
Construction	2	508	—	—	—	508
Other commercial real estate	5	526	—	—	—	526
Home equity	9	947	—	—	—	947
1-4 family mortgages	1	132	—	4	—	136
Total TDRs restructured during the period	35	\$20,102	\$30	\$63	\$—	\$20,195

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

TDRs That Defaulted Within Twelve Months of the Restructure Date

(Dollar amounts in thousands)

	Quarters Ended September 30,				Nine Months Ended September 30,			
	2014		2013		2014		2013	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial and industrial	—	\$—	—	\$—	2	\$125	1	\$350
Other commercial real estate	—	—	—	—	—	—	3	354
Home equity	1	77	—	—	1	77	—	—
Total	1	\$77	—	\$—	3	\$202	4	\$704

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

TDR Rollforward

(Dollar amounts in thousands)

	Quarters Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Accruing				
Beginning balance	\$5,697	\$8,287	\$23,770	\$6,867
Additions	417	1,128	492	4,606
Net payments received	(109)	(248)	(1,219)	(415)
Returned to performing status	—	—	(18,821)	(5,037)
Net transfers from non-accrual	(556)	15,162	1,227	18,308
Ending balance	5,449	24,329	5,449	24,329
Non-accrual				
Beginning balance	1,700	18,450	4,083	10,924
Additions	23,015	1,747	23,015	15,589
Net payments received	(135)	(201)	(292)	(735)
Charge-offs	(8,159)	(62)	(8,345)	(1,850)
Transfers to OREO	—	(35)	(257)	(77)
Loans sold	—	—	—	(806)
Net transfers to accruing	556	(15,162)	(1,227)	(18,308)
Ending balance	16,977	4,737	16,977	4,737
Total TDRs	\$22,426	\$29,066	\$22,426	\$29,066

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

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

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8. EARNINGS PER COMMON SHARE

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

Basic and Diluted Earnings per Common Share

(Amounts in thousands, except per share data)

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net income	\$18,549	\$29,323	\$54,713	\$60,141
Net income applicable to non-vested restricted shares	(242	) (416	) (697	) (847
Net income applicable to common shares	\$18,307	\$28,907	\$54,016	\$59,294
Weighted-average common shares outstanding:				
Weighted-average common shares outstanding (basic)	74,341	74,023	74,270	73,969
Dilutive effect of common stock equivalents	11	11	12	9
Weighted-average diluted common shares outstanding	74,352	74,034	74,282	73,978
Basic earnings per common share	\$0.25	\$0.39	\$0.73	\$0.80
Diluted earnings per common share	\$0.25	\$0.39	\$0.73	\$0.80
Anti-dilutive shares not included in the computation of diluted earnings per common share ⁽¹⁾	1,155	1,412	1,215	1,483

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

9. INCOME TAXES

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

Income Tax Expense

(Dollar amounts in thousands)

	Quarters Ended		Nine Months Ended		
	September 30,		September 30,		
	2014	2013	2014	2013	
Income before income tax expense	\$27,098	\$54,282	\$80,076	\$99,348	
Income tax expense:					
Federal income tax expense	\$6,714	\$19,145	\$19,719	\$29,058	
State income tax expense	1,835	5,814	5,644	10,149	
Total income tax expense	\$8,549	\$24,959	\$25,363	\$39,207	
Effective income tax rate	31.5	% 46.0	% 31.7	% 39.5	%

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

Effective tax rates were elevated for the quarter and nine months ended September 30, 2013 due to a \$34.0 million gain recognized on the sale of an equity investment and a \$7.8 million gain on the termination of two FHLB forward commitments, which were taxed at statutory rates, and a \$13.3 million non-deductible BOLI modification loss. Excluding these transactions, the effective tax rate for the quarter and nine months ended September 30, 2013 would have been 30.5% and 31.2%, respectively. In addition, an increase in income exempt from state taxes contributed to the decrease in the effective income tax rate compared to both prior periods.

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

10. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

Fair Value Hedges

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

Fair Value Hedges

(Dollar amounts in thousands)

	September 30, 2014		December 31, 2013	
Gross notional amount outstanding	\$13,854		\$14,730	
Derivative liability fair value	(1,103	)	(1,472)
Weighted-average interest rate received	2.07	%	2.08	%
Weighted-average interest rate paid	6.38	%	6.39	%
Weighted-average maturity (in years)	3.02		3.76	
Fair value of assets needed to settle derivative transactions ⁽¹⁾	\$1,130		\$1,502	

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

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

Cash Flow Hedges

During the nine months ended September 30, 2014, the Company hedged \$325.0 million of certain corporate variable rate loans using interest rate swaps through which the Company receives fixed amounts and pays variable amounts. The Company also hedged \$325.0 million of borrowed funds using four forward starting interest rate swaps through which the Company receives variable amounts and pays fixed amounts. The four forward starting interest rate swaps begin in 2015 and 2016 and mature in 2019. These derivative contracts are designated as cash flow hedges.

Cash Flow Hedges

(Dollar amounts in thousands)

	September 30, 2014		December 31, 2013	
Gross notional amount outstanding	\$650,000		\$—	
Derivative asset fair value	1,156		—	
Derivative liability fair value	(1,983)	—	
Weighted-average interest rate received	1.63	%	—	
Weighted-average interest rate paid	0.16	%	—	
Weighted-average maturity (in years)	4.77		—	

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

relationship and on an ongoing basis. For the quarter ended September 30, 2014, there were no gains or losses related to cash flow hedge ineffectiveness. As of September 30, 2014, the Company estimates that \$4.0 million will be reclassified from accumulated other comprehensive income as an increase to interest income over the next twelve months.

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Other Derivative Instruments

The Company also enters into derivative transactions with its commercial customers and simultaneously enters into an offsetting interest rate derivative transaction with a third party. This transaction allows the Company's customers to effectively convert a variable rate loan into a fixed rate loan. Due to the offsetting nature of these transactions, the Company does not apply hedge accounting treatment. Transaction fees related to commercial customer derivative instruments of \$874,000 and \$1.3 million were recorded in noninterest income for the quarter and nine months ended September 30, 2014, respectively. There were \$1.4 million and \$2.0 million in transaction fees recorded for the quarter and nine months ended September 30, 2013, respectfully.

Other Derivative Instruments
(Dollar amounts in thousands)

	September 30, 2014	December 31, 2013
Gross notional amount outstanding	\$432,977	\$256,638
Derivative asset fair value	4,916	2,235
Derivative liability fair value	(4,916	) (2,235
Fair value of assets needed to settle derivative transactions ⁽¹⁾	4,899	1,305

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

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

Credit Risk

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

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

Offsetting Derivatives

(Dollar amounts in thousands)

	Derivative Assets Fair Value		Derivative Liabilities Fair Value	
	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
Gross amounts recognized	\$6,072	\$2,235	\$8,002	\$3,707
Less: amounts offset in the Consolidated Statements of Financial Condition	—	—	—	—
Net amount presented in the Consolidated Statements of Financial Condition ⁽¹⁾	6,072	2,235	8,002	3,707
Gross amounts not offset in the Consolidated Statements of Financial Condition				
Offsetting derivative positions	(1,156	) (704	) (1,156	) (704
Cash collateral pledged ⁽²⁾	—	—	(6,846	) (3,003
Net credit exposure	\$4,916	\$1,531	\$—	\$—

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

The Company pledged cash collateral of \$5.8 million and \$3.0 million as of September 30, 2014 and December 31, 2013, respectively, which resulted in a shortage of collateral with counterparties as of September 30, 2014. For purposes of this disclosure, the amount of cash collateral is increased, given excess derivative assets, to fully offset the derivative liability.

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

11. COMMITMENTS, GUARANTEES, AND CONTINGENT LIABILITIES

Credit Commitments and Guarantees

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

Contractual or Notional Amounts of Financial Instruments

(Dollar amounts in thousands)

	September 30, 2014	December 31, 2013
Commitments to extend credit:		
Commercial, industrial, and agricultural	\$ 1,202,700	\$ 1,077,201
Commercial real estate	172,012	133,867
Home equity	293,122	268,311
Other commitments ⁽¹⁾	187,385	181,702
Total commitments to extend credit	\$ 1,855,219	\$ 1,661,081
Standby letters of credit	\$ 125,569	\$ 110,453
Recourse on assets sold:		
Unpaid principal balance of loans sold	\$ 182,834	\$ 170,330
Carrying value of recourse obligation ⁽²⁾	158	162

⁽¹⁾ Other commitments includes installment and overdraft protection program commitments.

⁽²⁾ Included in other liabilities in the Consolidated Statements of Financial Condition.

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

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

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

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

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

Legal Proceedings

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

12. FAIR VALUE

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

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

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

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

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

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

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

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

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

Recurring Fair Value Measurements

(Dollar amounts in thousands)

	September 30, 2014			December 31, 2013		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets:						
Trading securities:						
Money market funds	\$1,383	\$—	\$—	\$1,847	\$—	\$—
Mutual funds	16,545	—	—	15,470	—	—
Total trading securities	17,928	—	—	17,317	—	—
Securities available-for-sale:						
U.S. Agency securities	—	500	—	—	500	—
CMOs	—	416,547	—	—	475,768	—
Other MBSs	—	120,489	—	—	136,164	—
Municipal securities	—	435,072	—	—	461,393	—
CDOs	—	—	18,369	—	—	18,309
Corporate debt securities	—	3,846	—	—	14,929	—
Equity securities	44	2,553	—	44	5,618	—
Total securities available-for-sale	44	979,007	18,369	44	1,094,372	18,309
Mortgage servicing rights ⁽¹⁾	—	—	1,942	—	—	1,893
Derivative assets ⁽¹⁾	—	6,072	—	—	2,235	—
Liabilities:						
Derivative liabilities ⁽²⁾	\$—	\$8,002	\$—	\$—	\$3,707	\$—

⁽¹⁾ Included in other assets in the Consolidated Statements of Financial Condition.

⁽²⁾ Included in other liabilities in the Consolidated Statements of Financial Condition.

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

Trading Securities

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

Securities Available-for-Sale

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

CDOs are classified in level 3 of the fair value hierarchy. The Company estimates the fair values for each CDO using discounted cash flow analyses with the assistance of a structured credit valuation firm. This methodology relies on

credit analysis and review of historical financial data for each of the issuers of the securities underlying the individual CDO (the "Issuers") to estimate the expected future cash flows. These estimates are highly subjective and sensitive to several significant, unobservable inputs, including prepayment assumptions, default probabilities, loss given default assumptions, and deferral cure probabilities. The expected future

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cash flows for each Issuer are then discounted to present values using LIBOR plus an adjustment to reflect the higher risk inherent in these securities given their complex structures and the impact of market factors. Finally, the discounted expected future cash flows for each Issuer are aggregated to derive the estimated fair value for the specific CDO. Information for each CDO, as well as the significant unobservable assumptions, is presented in the following table.

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

	CDO Number					
	1	2	3	4	5	
Characteristics:						
Class	C-1	C-1	C-1	B1	C	
Original par	\$17,500	\$15,000	\$15,000	\$15,000	\$6,500	
Amortized cost	7,140	5,598	12,377	13,727	6,179	
Fair value	4,837	704	4,872	5,428	2,528	
Lowest credit rating (Moody's)	Ca	Ca	Ca	Ca	Ca	
Number of underlying Issuers	43	54	57	56	74	
Percent of Issuers currently performing	83.7	% 81.5	% 77.2	% 62.5	% 73.0	%
Current deferral and default percent ⁽¹⁾	8.7	% 10.3	% 11.0	% 24.4	% 22.5	%
Expected future deferral and default percent ⁽²⁾	12.2	% 10.8	% 13.5	% 19.0	% 9.6	%
Excess subordination percent ⁽³⁾	—	% —	% —	% 10.3	% 10.1	%
Discount rate risk adjustment ⁽⁴⁾	12.5	% 14.3	% 13.3	% 11.8	% 12.3	%
Significant unobservable inputs, weighted average of Issuers:						
Probability of prepayment	15.2	% 7.6	% 4.5	% 4.5	% 3.5	%
Probability of default	18.5	% 22.2	% 19.8	% 26.0	% 28.8	%
Loss given default	88.2	% 83.2	% 89.4	% 93.2	% 96.3	%
Probability of deferral cure	23.2	% 12.4	% 36.3	% 38.8	% 27.6	%

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

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

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

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

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

Most Issuers have the right to prepay the securities on the fifth anniversary of issuance and under other limited circumstances. To estimate prepayments, a credit analysis of each Issuer is performed to estimate its ability and likelihood to fund a prepayment. If a prepayment occurs, the Company receives cash equal to the par value for the portion of the CDO associated with that Issuer.

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

financial viability.

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

Management monitors the valuation results of each CDO on a quarterly basis, which includes an analysis of historical pricing trends for these types of securities, overall economic conditions (such as tracking LIBOR curves), and the performance of the

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Issuers' industries. Management also reviews market activity for the same or similar tranches of the CDOs, when available. Annually, management validates significant assumptions by reviewing detailed back-testing performed by the structured credit valuation firm.

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

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

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Beginning balance	\$18,436	\$14,917	\$18,309	\$12,129
Change in other comprehensive (loss) income ⁽¹⁾	(65	) 2,079	1,571	4,867
Purchases, sales, issuances, settlements, and paydowns ⁽²⁾	(2	) —	(1,511) —
Ending balance	\$18,369	\$16,996	\$18,369	\$16,996
Change in unrealized losses recognized in earnings related to securities still held at end of period	\$—	\$—	\$—	\$—

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

⁽²⁾ For the nine months ended September 30, 2014, one CDO with a carrying value of \$1.3 million was sold. In addition, one CDO with a carrying value of zero was sold during the nine months ended September 30, 2013.

Mortgage Servicing Rights

The Company services loans for others totaling \$218.9 million as of September 30, 2014 and \$214.5 million as of December 31, 2013. These loans are owned by third parties and are not included in the Consolidated Statements of Condition. The Company estimates the fair value of mortgage servicing rights by using a discounted cash flow analysis and classifies them in level 3 of the fair value hierarchy. Additional information regarding the Company's mortgage servicing rights can be found in Note 21, "Fair Value," in the Company's 2013 10-K.

Derivative Assets and Derivative Liabilities

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

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

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

Non-Recurring Fair Value Measurements

(Dollar amounts in thousands)

	September 30, 2014			December 31, 2013		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Collateral-dependent impaired loans ⁽¹⁾	\$—	\$—	\$18,754	\$—	\$—	\$13,103
OREO ⁽²⁾	—	—	17,580	—	—	13,347
Loans held-for-sale ⁽³⁾	—	—	24,504	—	—	4,739
Assets held-for-sale ⁽⁴⁾	—	—	2,026	—	—	4,027

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

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

(3) Included in other assets in the Consolidated Statements of Financial Condition.

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

Collateral-Dependent Impaired Loans

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

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

OREO

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

Loans Held-for-Sale

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

Assets Held-for-Sale

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

Financial Instruments Not Required to be Measured at Fair Value

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

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

	Fair Value Hierarchy Level	September 30, 2014		December 31, 2013	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and due from banks	1	\$ 125,977	\$ 125,977	\$ 110,417	\$ 110,417
Interest-bearing deposits in other banks	2	550,606	550,606	476,824	476,824
Securities held-to-maturity	2	26,776	27,766	44,322	43,387
FHLB and Federal Reserve Bank stock	2	35,588	35,588	35,161	35,161
Net loans	3	6,445,973	6,315,474	5,628,855	5,544,146
FDIC indemnification asset	3	8,699	4,659	16,585	7,829
Investment in BOLI	3	195,270	195,270	193,167	193,167
Accrued interest receivable	3	27,375	27,375	25,735	25,735
Other interest earning assets	3	4,399	4,527	6,550	6,809
Liabilities:					
Deposits	2	\$ 7,616,133	\$ 7,610,119	\$ 6,766,101	\$ 6,765,404
Borrowed funds	2	132,877	132,877	224,342	226,839
Senior and subordinated debt	1	191,028	191,769	190,932	201,147
Accrued interest payable	2	5,208	5,208	2,400	2,400

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

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

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

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

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

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

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

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

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

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

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

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

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

INTRODUCTION

First Midwest Bancorp, Inc. (the "Company") is a bank holding company headquartered in the Chicago suburb of Itasca, Illinois with operations throughout the greater Chicago metropolitan area as well as northwest Indiana, central and western Illinois, and eastern Iowa. Our principal subsidiary is First Midwest Bank (the "Bank"), which provides a broad range of commercial and retail banking and wealth management services to consumer, commercial and industrial, commercial real estate, and municipal customers through approximately 100 banking offices. We are committed to meeting the financial needs of the people and businesses in the communities where we live and work by providing customized banking solutions, quality products, and innovative services that fulfill those financial needs.

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

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

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

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

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

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

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

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

Forward-looking statements may be deemed to include, among other things, statements relating to our future financial performance, the performance of our loan or securities portfolio, the expected amount of future credit reserves or charge-offs, corporate strategies or objectives, anticipated trends in our business, regulatory developments, pending acquisition transactions, including estimated synergies, cost savings and financial benefits of pending or consummated transactions, and growth strategies, including possible future acquisitions. These statements are subject to certain risks, uncertainties and assumptions. For a discussion of these risks,

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

CRITICAL ACCOUNTING POLICIES

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

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

NON-GAAP FINANCIAL INFORMATION

The Company's accounting and reporting policies conform to GAAP and general practice within the banking industry. As a supplement to GAAP, the Company provides non-GAAP performance results, which the Company believes are useful because they assist investors in assessing the Company's operating performance. This includes, but is not limited to, earnings per share, excluding acquisition and integration related expenses, tax-equivalent net interest income (including its individual components), the efficiency ratio, tier 1 common capital to risk-weighted assets, tangible common equity to tangible assets, tangible common equity, excluding accumulated other comprehensive loss, to tangible assets, tangible common equity to risk-weighted assets, and return on average tangible common equity. Although intended to enhance investors' understanding of the Company's business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP.

PERFORMANCE OVERVIEW

Table 1

Selected Financial Data

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

	Quarters Ended		Nine Months Ended		
	September 30, 2014	2013	September 30, 2014	2013	
Operating Results					
Interest income	\$76,862	\$72,329	\$218,555	\$215,127	
Interest expense	5,831	6,663	17,522	20,683	
Net interest income	71,031	65,666	201,033	194,444	
Provision for loan and covered loan losses	10,727	4,770	17,509	16,257	
Noninterest income	37,107	58,088	95,550	113,104	
Noninterest expense	70,313	64,702	198,998	191,943	
Income before income tax expense	27,098	54,282	80,076	99,348	
Income tax expense	8,549	24,959	25,363	39,207	
Net income	\$18,549	\$29,323	\$54,713	\$60,141	
Weighted-average diluted common shares outstanding	74,352	74,034	74,282	73,978	
Diluted earnings per common share	\$0.25	\$0.39	\$0.73	\$0.80	
Performance Ratios ⁽¹⁾					
Return on average common equity	6.91	% 11.66	% 6.99	% 8.22	%
Return on average tangible common equity ⁽²⁾	11.73	% 16.33	% 10.58	% 11.58	%
Return on average assets	0.84	% 1.38	% 0.86	% 0.98	%
Net interest margin – tax equivalent	3.72	% 3.63	% 3.66	% 3.70	%
Efficiency ratio ⁽³⁾	62.02	% 62.70	% 64.00	% 64.46	%

⁽¹⁾ All ratios are presented on an annualized basis.⁽²⁾ Tangible common equity (“TCE”) represents common stockholders’ equity less goodwill and identifiable intangible assets. Acquisition and integration related expenses of \$3.7 million and \$4.6 million for the quarter and nine months ended September 30, 2014, respectively, are excluded from the return on average tangible common equity ratio.⁽³⁾ The efficiency ratio expresses noninterest expense, excluding other real estate owned (“OREO”) expense, as a percentage of tax-equivalent net interest income plus total fee-based revenues, other income, net trading (losses) gains, and tax-equivalent adjusted BOLI income. In addition, acquisition and integration related expenses of \$3.7 million and \$4.6 million are excluded from the efficiency ratio for the quarter and nine months ended September 30, 2014, respectively.

	September 30,	December 31,	September 30,	September 30, 2014	
	2014	2013	2013	Change From December 31, 2013	September 30, 2013
Balance Sheet Highlights					
Total assets	\$9,096,351	\$8,253,407	\$8,517,913	\$842,944	\$578,438
Total loans, excluding covered loans	6,428,204	5,580,005	5,448,929	848,199	979,275
Total loans, including covered loans	6,519,079	5,714,360	5,602,234	804,719	916,845
Total deposits	7,616,133	6,766,101	7,003,208	850,032	612,925
Transactional deposits	6,359,686	5,558,318	5,745,047	801,368	614,639
Loans-to-deposits ratio	85.6	% 84.5	% 80.0	%	

Transactional deposits to total deposits	83.5	%	82.1	%	82.0	%
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	September 30, 2014	December 31, 2013	September 30, 2013	September 30, 2014 Change From December 31, 2013	September 30, 2013
Asset Quality Highlights ⁽¹⁾					
Non-accrual loans	\$63,858	\$59,798	\$68,170	\$4,060	\$(4,312)
90 days or more past due loans (still accruing interest)	5,983	3,708	5,642	2,275	341
Total non-performing loans	69,841	63,506	73,812	6,335	(3,971)
Accruing troubled debt restructurings ("TDRs")	5,449	23,770	24,329	(18,321)	(18,880)
OREO	29,165	32,473	35,616	(3,308)	(6,451)
Total non-performing assets	\$104,455	\$119,749	\$133,757	\$(15,294)	\$(29,302)
30-89 days past due loans (still accruing interest)	\$13,459	\$20,742	\$15,111	\$(7,283)	\$(1,652)
Allowance for Credit Losses					
Allowance for credit losses	\$74,722	\$87,121	\$93,214	\$(12,399)	\$(18,492)
Allowance for credit losses to loans, excluding acquired loans, including covered loans	1.25	% 1.52	% 1.66	%	
Allowance for credit losses to non-accrual loans, excluding acquired and covered loans	103.47	% 124.69	% 117.59	%	

Due to the impact of business combination accounting and protection provided by loss share agreements with the FDIC ("the FDIC Agreements"), acquired loans and covered loans and covered OREO are excluded from these ⁽¹⁾ metrics to provide for improved comparability to prior periods and better perspective into asset quality trends. For a discussion of acquired and covered loans, refer to Note 1 and Note 6 of "Notes to Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q. Asset quality, including acquired loans, covered loans, and covered OREO, is included in the "Loan Portfolio and Credit Quality" section below.

Net income for the third quarter of 2014 was \$18.5 million, or \$0.25 per share, compared to \$29.3 million, or \$0.39 per share, for the third quarter of 2013. For the nine months ended September 30, 2014, net income was \$54.7 million, or \$0.73 per share, compared to \$60.1 million, or \$0.80 per share, for the same period in 2013.

The third quarter of 2013 net income was impacted by certain significant transactions, which included a \$34.0 million gain on the sale of an equity investment, a \$7.8 million gain on the termination of two Federal Home Loan Bank ("FHLB") forward commitments, and a \$13.3 million non-deductible write-down of the cash surrender values of certain BOLI policies. Excluding these items, which were reported in noninterest income, net income for the third quarter of 2013 was \$17.5 million, or \$0.24 per share, compared to \$18.5 million, or \$0.25 per share, for third quarter of 2014. In addition, net income for the third quarter and nine months ended September 30, 2014 was impacted by acquisition and integration related expenses of \$3.7 million and \$4.6 million, respectively. A discussion of net interest income, noninterest income, and noninterest expense is presented in the following section titled "Earnings Performance."

Total loans, excluding covered loans, of \$6.4 billion rose by \$848.2 million from December 31, 2013. Total loans, excluding acquired and covered loans, grew 7.5% annualized from December 31, 2013. The majority of the loan growth was driven by the acquisition of Popular, which represents \$533.2 million of loans at September 30, 2014. The loan portfolio also benefited from solid performance from our legacy sales platform concentrated within our

commercial and industrial and agricultural loan categories.

Non-performing assets, excluding acquired and covered loans and covered OREO, decreased by \$15.3 million, or 12.8%, from December 31, 2013 and \$29.3 million, or 21.9% from September 30, 2013. Refer to the “Loan Portfolio and Credit Quality” section below for further discussion of our loan portfolio, non-accrual loans, 90 days past due loans, TDRs, and OREO.

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Acquisitions

On July 7, 2014, the Company entered into a definitive agreement to acquire the south suburban Chicago-based Great Lakes Financial Resources, Inc. ("Great Lakes"), the holding company for Great Lakes Bank, National Association. As part of the acquisition, the Company will acquire eight locations, approximately \$490 million in deposits, and \$234 million in loans. The Company has received approval for this acquisition from the Federal Reserve, its primary regulator, and the acquisition is expected to close before the end of 2014, subject to approval by the stockholders of Great Lakes and certain closing conditions.

On August 8, 2014, the Bank completed the acquisition of the Chicago area banking operations of Banco Popular North America ("Popular"), doing business as Popular Community Bank, which is a subsidiary of Popular, Inc. The acquisition included Popular's twelve full-service retail banking offices and its small business and middle market commercial lending activities in the Chicago metropolitan area. On the date of acquisition, the Bank assumed \$731.9 million in deposits and acquired \$549.4 million in loans.

On September 26, 2014, the Bank completed the acquisition of National Machine Tool Financial Corporation ("National Machine Tool"). In business for more than 28 years and a customer of the Bank for more than 15 years, National Machine Tool provides equipment leasing and financing alternatives to traditional bank financing. The addition of equipment leasing to First Midwest's product offerings affords us the opportunity to leverage our sales platform to augment National Machine Tool's historical lease production of approximately \$40 million per year.

EARNINGS PERFORMANCE

Net Interest Income

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

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

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

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

	Quarters Ended September 30, 2014			2013			Attribution of Change in Net Interest Income ⁽¹⁾		
	Average Balance	Interest	Yield/ Rate (%)	Average Balance	Interest	Yield/ Rate (%)	Volume	Yield/ Rate	Total
Assets:									
Other interest-earning assets	\$476,768	\$313	0.26	\$661,779	\$469	0.28	\$(74)	\$(82)	\$(156)
Trading securities	18,363	30	0.65	15,543	29	0.75	4	(3)	1
Investment securities ⁽²⁾	1,067,742	9,659	3.62	1,250,158	10,199	3.26	(2,126)	1,586	(540)
FHLB and Federal Reserve	35,588	341	3.83	35,162	333	3.79	4	4	8
Bank stock									
Loans ⁽²⁾⁽³⁾	6,302,883	69,458	4.37	5,559,932	64,326	4.59	6,708	(1,576)	5,132
Total interest-earning assets ⁽²⁾	7,901,344	79,801	4.01	7,522,574	75,356	3.98	4,516	(71)	4,445
Cash and due from banks	126,279			127,847					
Allowance for loan and covered loan losses	(77,596)			(93,940)					
Other assets	818,066			847,304					
Total assets	\$8,768,093			\$8,403,785					
Liabilities and Stockholders' Equity:									
Savings deposits	\$1,231,700	231	0.07	\$1,127,970	192	0.07	39	—	39
NOW accounts	1,261,522	166	0.05	1,175,926	162	0.05	4	—	4
Money market deposits	1,413,753	468	0.13	1,343,263	411	0.12	22	35	57
Time deposits	1,226,025	1,941	0.63	1,288,746	2,072	0.64	(99)	(32)	(131)
Borrowed funds	101,674	9	0.04	203,613	390	0.76	(190)	(191)	(381)
Senior and subordinated debt	191,013	3,016	6.26	214,860	3,436	6.34	(377)	(43)	(420)
Total interest-bearing liabilities	5,425,687	5,831	0.43	5,354,378	6,663	0.49	(601)	(231)	(832)
Demand deposits	2,208,450			1,975,797					
Other liabilities	83,075			90,154					
Stockholders' equity - common	1,050,881			983,456					
Total liabilities and stockholders' equity	\$8,768,093			\$8,403,785					
Net interest income/margin ⁽²⁾		\$73,970	3.72		\$68,693	3.63	\$5,117	\$160	\$5,277
Net interest income (GAAP)		\$71,031			\$65,666				
Tax equivalent adjustment		2,939			3,027				
Tax-equivalent net interest income		\$73,970			\$68,693				

- (1) For purposes of this table, changes which are not due solely to volume changes or rate changes are allocated to these categories on the basis of the percentage relationship of each to the sum of the two.
- (2) Interest income and yields are presented on a tax-equivalent basis, assuming a federal income tax rate of 35%. This item includes covered interest-earning assets consisting of loans acquired through the Company's Federal
- (3) Deposit Insurance Corporation ("FDIC")-assisted transactions with loss share agreements and the related FDIC indemnification asset. For additional discussion, please refer to Note 1 and Note 6 of "Notes to the Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q.

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

	Nine Months Ended September 30, 2014			2013			Attribution of Change in Net Interest Income ⁽¹⁾		
	Average Balance	Interest	Yield/ Rate (%)	Average Balance	Interest	Yield/ Rate (%)	Volume	Yield/ Rate	Total
Assets:									
Other interest-earning assets	\$515,380	\$1,064	0.28	\$640,551	\$1,371	0.29	\$(165)	\$(142)	\$(307)
Trading securities	17,919	86	0.64	15,174	89	0.78	16	(19)	(3)
Investment securities ⁽²⁾	1,115,882	30,317	3.62	1,227,619	30,303	3.29	(132)	146	14
FHLB and Federal Reserve	35,424	1,024	3.85	41,086	1,014	3.29	(41)	51	10
Bank stock									
Loans ⁽²⁾⁽³⁾	5,978,223	194,878	4.36	5,439,308	191,605	4.71	30,628	(27,355)	3,273
Total interest-earning assets ⁽²⁾	7,662,828	227,369	3.97	7,363,738	224,382	4.07	30,306	(27,319)	2,987
Cash and due from banks	118,350			121,037					
Allowance for loan and covered loan losses	(81,098)			(96,991)					
Other assets	790,782			858,347					
Total assets	\$8,490,862			\$8,246,131					
Liabilities and Stockholders' Equity:									
Savings deposits	\$1,193,952	636	0.07	\$1,126,501	647	0.08	54	(65)	(11)
NOW accounts	1,213,471	488	0.05	1,162,657	505	0.06	25	(42)	(17)
Money market deposits	1,353,857	1,253	0.12	1,289,857	1,315	0.14	72	(134)	(62)
Time deposits	1,197,232	5,537	0.62	1,331,277	6,693	0.67	(644)	(512)	(1,156)
Borrowed funds	162,481	561	0.46	202,664	1,217	0.80	(534)	(122)	(656)
Senior and subordinated debt	190,981	9,047	6.33	214,829	10,306	6.41	(1,131)	(128)	(1,259)
Total interest-bearing liabilities	5,311,974	17,522	0.44	5,327,785	20,683	0.52	(2,158)	(1,003)	(3,161)
Demand deposits	2,069,866			1,866,560					
Other liabilities	75,268			87,651					
Stockholders' equity - common	1,033,754			964,135					
Total liabilities and stockholders' equity	\$8,490,862			\$8,246,131					
Net interest income/margin ⁽²⁾		\$209,847	3.66		\$203,699	3.70	\$32,464	\$(26,316)	\$6,148
Net interest income (GAAP)		\$201,033			\$194,444				
		8,814			9,255				

Tax equivalent adjustment		
Tax-equivalent net interest income	\$209,847	\$203,699

- (1) For purposes of this table, changes which are not due solely to volume changes or rate changes are allocated to these categories on the basis of the percentage relationship of each to the sum of the two.
- (2) Interest income and yields are presented on a tax-equivalent basis, assuming a federal income tax rate of 35%. This item includes covered interest-earning assets consisting of loans acquired through the Company's FDIC-assisted transactions with loss share agreements and the related FDIC indemnification asset. For additional discussion, please refer to Note 1 and Note 6 of "Notes to the Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q.
- (3)

Total average interest-earning assets for the third quarter of 2014 increased by \$378.8 million from the third quarter of 2013 and \$299.1 million for the first nine months of 2014 compared to the same period in 2013. The increase compared to both prior periods was driven by loans acquired in the Popular acquisition and organic loan growth.

The \$71.3 million increase in average interest-bearing liabilities compared to the third quarter of 2013 resulted primarily from the Popular acquisition. Compared to the first nine months of 2013, average interest-bearing liabilities decreased \$15.8 million primarily

due to lower levels of time deposits, the repurchase and retirement of \$24.0 million of junior subordinated debentures with a rate of 6.95%, and the prepayment of \$114.6 million of FHLB advances with a weighted-average rate of 1.08%, which is net of the yield earned on the cash used for the prepayment. These declines were substantially offset by \$731.9 million of deposits assumed in the Popular acquisition.

Tax-equivalent net interest margin for the third quarter of 2014 was 3.72%, an increase of 9 basis points from the third quarter of 2013. The Popular acquisition contributed approximately half of the improvement, adding a greater proportion of higher yielding, fixed rate loans along with low cost deposits. In addition, certain loan hedging strategies and an increase in the yield on covered interest-earning assets drove the higher margin.

For the nine months ended September 30, 2014, tax-equivalent net interest margin was 3.66%, a decline of 4 basis points from the same period in 2013. The decrease in the yield on loans was driven by the flattening of the yield curve, the competitive market environment, and a continued shift in the loan mix to floating rate loans. This decline was partially offset by higher yielding, fixed rate loans acquired in the Popular transaction, certain loan hedging strategies, and an increase in the yield on covered interest-earning assets. Overall, the reduction in net interest margin was partially offset by higher yields on investment securities, a reduction in higher cost borrowed funds, and growth in core deposits.

Higher tax-equivalent net interest income of \$5.3 million compared to the third quarter of 2013 and \$6.1 million compared to the first nine months of 2013 was primarily due to the Popular acquisition, which contributed \$3.5 million of the increase. In addition, continued organic loan growth, the prepayment of FHLB advances, and repurchase and retirement of junior subordinated debentures contributed to the positive variance.

Noninterest Income

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

Table 4
Noninterest Income Analysis
(Dollar amounts in thousands)

	Quarters Ended			Nine Months Ended		
	September 30,		% Change	September 30,		% Change
	2014	2013		2014	2013	
Service charges on deposit accounts	\$9,902	\$9,472	4.5	\$26,895	\$27,267	(1.4)
Wealth management fees	6,721	6,018	11.7	19,730	17,983	9.7
Card-based fees ⁽¹⁾	6,646	5,509	20.6	17,950	16,132	11.3
Merchant servicing fees ⁽²⁾	2,932	2,915	0.6	8,557	8,368	2.3
Mortgage banking income	1,125	1,273	(11.6)	3,199	4,251	(24.7)
Other service charges, commissions, and fees ⁽²⁾	2,334	2,617	(10.8)	5,386	5,569	(3.3)
Total fee-based revenues	29,660	27,804	6.7	81,717	79,570	2.7
Gains on sales of properties	3,954	—	100.0	3,954	—	100.0
Net securities gains	2,570	33,801	(92.4)	8,160	34,017	(76.0)
BOLI income ⁽³⁾	767	284	N/M	2,030	884	N/M
Other income ⁽⁴⁾⁽⁶⁾	512	800	(36.0)	1,382	1,984	(30.3)
Net trading (losses) gains ⁽⁵⁾⁽⁶⁾	(356)	882	N/M	366	2,132	(82.8)
Loss on early extinguishment of debt	—	—	—	(2,059)	—	(100.0)
BOLI modification loss ⁽³⁾	—	(13,312)	100.0	—	(13,312)	100.0
Gain on termination of FHLB forward commitments	—	7,829	(100.0)	—	7,829	(100.0)
Total noninterest income	\$37,107	\$58,088	(36.1)	\$95,550	\$113,104	(15.5)

N/M - Not meaningful.

Card-based fees consist of debit and credit card interchange fees for processing transactions as well as various fees ⁽¹⁾ on both customer and non-customer automated teller machine (“ATM”) and point-of-sale transactions processed through the ATM and point-of-sale networks.

⁽²⁾ These line items are included in other service charges, commissions, and fees in the Condensed Consolidated Statements of Income.

⁽³⁾ These line items are included in BOLI income in the Condensed Consolidated Statements of Income.

⁽⁴⁾ Other income consists of various items, including safe deposit box rentals, miscellaneous recoveries, and gains on the sales of various assets.

Net trading (losses) gains result from changes in the fair value of diversified investment securities held in a grantor ⁽⁵⁾ trust under deferred compensation arrangements and are substantially offset by nonqualified plan expense for each period presented.

⁽⁶⁾ These line items are included in other income in the Condensed Consolidated Statements of Income.

Total fee-based revenues continue to be strong and grew to \$29.7 million, an increase of 6.7% compared to the third quarter of 2013 and 2.7% from the first nine months of 2013.

Compared to the third quarter of 2013, service charges on deposit accounts were impacted by an increase in service charge volume from existing clients and new customers acquired in the Popular transaction. A lower volume of

non-sufficient funds transactions contributed to the decrease in service charges on deposit accounts compared to the nine months ended September 30, 2013.

Wealth management fees increased 11.7% from the third quarter of 2013 and 9.7% from the first nine months of 2013 due to a 10.9% rise in assets under management driven by new customer relationships across all service offerings.

The growth in card-based fees compared to both prior periods reflects higher transaction volumes as well as incentives from a renewed vendor contract.

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During the third quarter and first nine months of 2014, we sold \$31.7 million and \$114.7 million of 1-4 family mortgage loans, respectively, compared to \$36.1 million and \$118.1 million of loans sold during the same periods in 2013. Lower market pricing contributed to the decline in mortgage banking income compared to the third quarter of 2013.

Lower levels of fee income from sales of capital market products to commercial clients contributed to the decrease in other service charges, commissions, and fees compared to the quarter and nine months ended September 30, 2013.

In the third quarter of 2014, we completed the disposition of two branch properties at pre-tax gains of \$4.0 million as part of multi-year efforts to optimize our retail distribution.

Net securities gains for the third quarter of 2014 were driven by the sale of longer-duration corporate bonds and other investments, resulting in pre-tax gains of \$2.6 million. Net securities gains for the first nine months of 2014 also consisted of the sale of a non-accrual trust-preferred collateralized debt obligation ("CDO") at a pre-tax gain of \$3.5 million and sales of municipal securities and other investments at pre-tax gains of \$2.1 million.

During the first nine months of 2014, the loss on early extinguishment of debt resulted from the prepayment of \$114.6 million in FHLB advances.

Total noninterest income was impacted by certain significant transactions during the third quarter of 2013, including a \$34.0 million gain on the sale of an equity investment, a \$7.8 million gain on the termination of two FHLB forward commitments, and a \$13.3 million write-down of the cash surrender values of certain BOLI policies.

Noninterest Expense

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

Table 5
Noninterest Expense Analysis
(Dollar amounts in thousands)

	Quarters Ended September 30,			Nine Months Ended September 30,		
	2014	2013	% Change	2014	2013	% Change
Salaries and employee benefits:						
Salaries and wages	\$28,972	\$27,254	6.3	\$84,022	\$81,646	2.9
Nonqualified plan expense ⁽¹⁾	(386)	1,003	N/M	350	2,394	(85.4)
Retirement and other employee benefits	7,347	6,013	22.2	19,613	19,720	(0.5)
Total salaries and employee benefits	35,933	34,270	4.9	103,985	103,760	0.2
Net occupancy and equipment expense	8,702	7,982	9.0	25,765	23,922	7.7
Professional services:						
Loan remediation costs	2,107	1,893	11.3	6,336	6,579	(3.7)
Other professional services	4,991	3,624	37.7	12,668	9,751	29.9
Professional services	7,098	5,517	28.7	19,004	16,330	16.4
Technology and related costs	4,316	2,984	44.6	10,494	8,351	25.7
Net OREO expense ⁽²⁾	1,406	2,849	(50.6)	4,531	5,732	(21.0)
Advertising and promotions ⁽²⁾	1,858	2,166	(14.2)	5,778	5,609	3.0
Merchant card expense ⁽²⁾	2,396	2,339	2.4	6,992	6,704	4.3
Cardholder expenses ⁽²⁾	1,120	1,031	8.6	3,215	3,003	7.1
Other expenses ⁽²⁾	7,484	5,564	34.5	19,234	18,532	3.8
Total noninterest expense	\$70,313	\$64,702	8.7	\$198,998	\$191,943	3.7
Efficiency ratio ⁽³⁾	62.02	% 62.70	%	64.00	% 64.46	%

N/M - Not meaningful.

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

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

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

⁽³⁾ The efficiency ratio expresses noninterest expense, excluding OREO expense, as a percentage of tax-equivalent net interest income plus total fee-based revenues, other income, net trading (losses) gains, and tax-equivalent adjusted BOLI income. In addition, acquisition and integration related expenses of \$3.7 million and \$4.6 million are excluded from the efficiency ratio for the quarter and nine months ended September 30, 2014, respectively.

The efficiency ratio, excluding acquisition and integration related expenses, improved to 62.02% for the third quarter of 2014 and 64.00% for the first nine months of 2014. Total noninterest expense for the third quarter of 2014 increased 8.7% from the third quarter of 2013 and 3.7% for the first nine months of 2014 compared to the same periods in 2013. The rise in total noninterest expense compared to both prior periods resulted primarily from acquisition and integration related expenses, totaling \$3.7 million for the third quarter of 2014 and \$4.6 million for the

nine months ended September 30, 2014. In addition, the recurring costs associated with operating the newly acquired Popular locations contributed to the increase. During the third quarter of 2014, the Company also recorded a \$430,000 valuation adjustment relative to the closing of a banking facility.

Compared to both prior periods presented, the increase in salaries and employee benefits resulted from additional employees assumed in the Popular acquisition during the third quarter of 2014. The timing of certain incentive compensation accruals and higher premiums paid for employee insurance also contributed to the variance compared to the third quarter of 2013.

Net occupancy and equipment expense increased for the third quarter of 2014 and nine months ended September 30, 2014 due to the acquisition of twelve branches in the Popular transaction and an increase in real estate taxes. Additionally, higher utilities and snow removal costs during the first quarter of 2014 impacted the comparison to the first nine months of 2013.

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The rise in loan remediation costs compared to the third quarter of 2013 resulted from higher levels of real estate taxes paid to preserve the Company's rights to collateral associated with problem loans and an increase in appraisal costs for underlying collateral. Compared to the first nine months of 2013, loan remediation costs decreased due to lower servicing costs for our covered loan portfolio and a reduction in real estate taxes paid, which was partially offset by higher appraisal costs.

Other professional services expense increased compared to the third quarter and first nine months of 2013. These increases were driven primarily by legal expenses related to acquisition activity which totaled \$1.4 million for the third quarter of 2014 and \$2.2 million for the first nine months of 2014.

Higher levels of technology and related costs compared to both prior periods presented resulted mainly from conversion costs related to acquisition activity, which totaled \$1.1 million for the quarter and nine months ended September 30, 2014.

Compared to both prior periods presented, the decrease in net OREO expense resulted primarily from net gains on sales of OREO properties compared to net losses on sales, as well as lower levels of operating expenses. Higher levels of valuation adjustments partially offset these declines.

Advertising and promotions expense declined compared to the third quarter of 2013 due to the timing of certain advertising costs.

Higher levels of other expenses in the third quarter and first nine months of 2014 resulted from a \$430,000 valuation adjustment relative to the closing of a banking facility and miscellaneous expenses related to the Popular acquisition.

Income Taxes

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

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

	Quarters Ended		Nine Months Ended		
	September 30,		September 30,		
	2014	2013	2014	2013	
Income before income tax expense	\$27,098	\$54,282	\$80,076	\$99,348	
Income tax expense:					
Federal income tax expense	\$6,714	\$19,145	\$19,719	\$29,058	
State income tax expense	1,835	5,814	5,644	10,149	
Total income tax expense	\$8,549	\$24,959	\$25,363	\$39,207	
Effective income tax rate	31.5	% 46.0	% 31.7	% 39.5	%

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

Effective tax rates were elevated for the quarter and nine months ended September 30, 2013 due to a \$34.0 million gain recognized on the sale of an equity investment and a \$7.8 million gain on the termination of two FHLB forward

commitments, which was taxed at statutory rates, and a \$13.3 million non-deductible BOLI modification loss. Excluding these transactions, the effective tax rate for the quarter and nine months ended September 30, 2013 would have been 30.5% and 31.2%, respectively. In addition, an increase in income exempt from state taxes contributed to the decrease in the effective income tax rate compared to both prior periods.

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

FINANCIAL CONDITION

Investment Portfolio Management

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

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

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

Table 7

Investment Portfolio Valuation Summary

(Dollar amounts in thousands)

	September 30, 2014				December 31, 2013			
	Amortized Cost	Net Unrealized Gains (Losses)	Fair Value	% of Total	Amortized Cost	Net Unrealized Gains (Losses)	Fair Value	% of Total
Securities Available-for-Sale								
U.S. agency securities	\$500	\$—	\$500	—	\$500	\$—	\$500	—
Collateralized mortgage obligations ("CMOs")	424,946	(8,399)	416,547	40.6	490,962	(15,194)	475,768	41.2
Other mortgage-backed securities ("MBSs")	117,271	3,218	120,489	11.8	135,097	1,067	136,164	11.8
Municipal securities	423,904	11,168	435,072	42.4	457,318	4,075	461,393	39.9
CDOs	45,021	(26,652)	18,369	1.8	46,532	(28,223)	18,309	1.6
Corporate debt securities	3,724	122	3,846	0.4	12,999	1,930	14,929	1.3
Equity securities	2,575	22	2,597	0.3	3,706	1,956	5,662	0.5
Total available-for-sale securities	1,017,941	(20,521)	997,420	97.3	1,147,114	(34,389)	1,112,725	96.3
Securities Held-to-Maturity	26,776	990	27,766	2.7	44,322	(935)	43,387	3.7

Municipal securities

Total securities	\$1,044,717	\$(19,531)	\$1,025,186	100.0	\$1,191,436	\$(35,324)	\$1,156,112	100.0
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Portfolio Composition

As of September 30, 2014, our securities portfolio totaled \$1.0 billion, decreasing 11.3% compared to December 31, 2013. The reduction in CMOs, MBSs, and municipal securities from December 31, 2013 resulted from sales of \$24.9 million and maturities, calls, and prepayments of \$125.2 million, which were slightly offset by purchases of \$16.4 million. Refer to the "Securities Gains and Losses" section below for further detail.

Approximately 97.5% of our available-for-sale securities portfolio is comprised of U.S. agency securities, CMOs, other MBSs, and municipal securities. The remainder of the portfolio consists of five CDOs with a total fair value of \$18.4 million and miscellaneous other securities with fair values of \$6.4 million.

Investments in municipal securities comprised 43.6%, or \$435.1 million, of the total available-for-sale securities portfolio at September 30, 2014. The majority consists of general obligations of local municipalities. Our municipal securities portfolio has historically experienced very low default rates and provides a predictable cash flow.

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

	September 30, 2014			December 31, 2013			Yield to Maturity ⁽³⁾	
	Effective Duration ⁽¹⁾	Average Life ⁽²⁾	Yield to Maturity ⁽³⁾	Effective Duration ⁽¹⁾	Average Life ⁽²⁾	Yield to Maturity ⁽³⁾		
Securities Available-for-Sale								
U.S. agency securities	1.49	% 1.50	0.49	% 2.23	% 2.25	0.49	%	
CMOs	3.92	% 3.95	1.87	% 4.48	% 4.26	1.86	%	
Other MBSs	3.20	% 4.42	3.00	% 3.93	% 4.85	2.45	%	
Municipal securities	3.31	% 2.57	5.52	% 5.11	% 3.27	5.53	%	
CDOs	N/M	N/M	N/M	N/M	N/M	N/M		
Corporate debt securities	0.43	% 0.48	4.59	% 4.86	% 7.18	6.39	%	
Equity securities	N/M	N/M	N/M	N/M	N/M	N/M		
Total available-for-sale securities	3.55	% 3.39	3.61	% 4.68	% 3.95	3.52	%	
Securities Held-to-Maturity								
Municipal securities	5.43	% 8.05	4.48	% 6.50	% 11.84	5.47	%	
Total securities	3.60	% 3.52	3.63	% 4.75	% 4.26	3.60	%	

N/M - Not meaningful.

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

(2) Average life is presented in years and represents the weighted-average time to receive half of all future cash flows using the dollar amount of principal paydowns, including estimated principal prepayments, as the weighting factor.

(3) Yields on municipal securities are reflected on a tax-equivalent basis, assuming a federal income tax rate of 35%.

Effective Duration

The average life and effective duration of our available-for-sale securities portfolio as of September 30, 2014 declined from December 31, 2013 since cash from maturities and sales of investment securities was not reinvested in the securities portfolio.

Securities Gains and Losses

Net securities gains for the third quarter and first nine months of 2014 were \$2.6 million and \$8.2 million, respectively. During the third quarter of 2014, we sold certain longer-duration corporate bonds with a carrying value of \$9.3 million at gains of \$2.0 million and certain other investments, which resulted in gains of \$552,000. Net securities gains for the first nine months of 2014 also consisted of the sale of a non-accrual CDO at a gain of \$3.5 million, sales of municipal securities at gains of \$468,000, and the sale of other investments at a gain of \$1.6 million.

Net securities gains for the third quarter and first nine months of 2013 were \$33.8 million and \$34.0 million, respectively, which resulted primarily from the sale of an equity investment. Net securities gains for the third quarter

of 2013 include other-than-temporary securities impairment ("OTTI") charges of \$404,000 on four municipal securities.

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Unrealized Gains and Losses

Unrealized gains and losses on securities available-for-sale represent the difference between the aggregate cost and fair value of the portfolio. These amounts are presented in the Consolidated Statements of Comprehensive Income and reported as a separate component of stockholders' equity in accumulated other comprehensive loss on an after-tax basis. This balance sheet component will fluctuate as current market interest rates and conditions change and affect the aggregate fair value of the portfolio. Net unrealized losses were \$20.5 million at September 30, 2014 compared to \$34.4 million at December 31, 2013.

Net unrealized losses in the CMO portfolio totaled \$8.4 million at September 30, 2014 compared to \$15.2 million at December 31, 2013. CMOs are either backed by U.S. government-owned agencies or issued by U.S. government-sponsored enterprises. We do not believe any individual unrealized loss on this type of security as of September 30, 2014 represents OTTI since the unrealized losses are not believed to be attributed to credit quality.

As of September 30, 2014, net unrealized gains in the municipal securities portfolio totaled \$11.2 million compared to \$4.1 million as of December 31, 2013. Net unrealized gains on municipal securities include unrealized losses of \$1.3 million at September 30, 2014. Substantially all of these securities carry investment grade ratings, with the majority supported by the general revenues of the issuing governmental entity, and are supported by third party bond insurance or other types of credit enhancement. We do not believe the unrealized loss on any of these securities represents OTTI.

Our investments in CDOs are supported by the credit of the underlying banks and insurance companies. The unrealized losses on these securities declined from \$28.2 million at December 31, 2013 to \$26.7 million at September 30, 2014. We do not believe the unrealized losses on the CDOs as of September 30, 2014 represent OTTI related to credit deterioration. In addition, we do not intend to sell the CDOs with unrealized losses within a short period of time, and we do not believe it is more likely than not that we will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Our estimation of fair values for the CDOs is based on discounted cash flow analyses as described in Note 12 of "Notes to the Condensed Consolidated Financial Statements," in Part I, Item 1 of this Form 10-Q.

LOAN PORTFOLIO AND CREDIT QUALITY

Loans Held-for-Investment

Our loan portfolio is comprised of both corporate and consumer loans with corporate loans representing 87.2% of total loans, excluding covered loans, at September 30, 2014. Consistent with our emphasis on relationship banking, the majority of our corporate loans are made to our core, multi-relationship customers. The customers usually maintain deposit relationships and utilize our other banking services, such as cash management or wealth management services.

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

Table 9

Loan Portfolio

(Dollar amounts in thousands)

	September 30, 2014		Total	% of Total	December 31, 2013	% of Total	% Change
	Legacy	Acquired ⁽¹⁾					
Commercial and industrial	\$2,131,464	\$76,702	\$2,208,166	34.3	\$1,830,638	32.8	20.6
Agricultural	347,391	120	347,511	5.4	321,702	5.8	8.0
Commercial real estate:							
Office	404,870	32,352	437,222	6.8	459,202	8.2	(4.8)
Retail	383,209	70,969	454,178	7.1	392,576	7.0	15.7
Industrial	486,723	44,399	531,122	8.3	501,907	9.0	5.8
Multi-family	360,330	199,359	559,689	8.7	332,873	6.0	68.1
Construction	193,445	—	193,445	3.0	186,197	3.3	3.9
Other commercial real estate	790,383	81,442	871,825	13.6	807,071	14.5	8.0
Total commercial real estate	2,618,960	428,521	3,047,481	47.5	2,679,826	48.0	13.7
Total corporate loans	5,097,815	505,343	5,603,158	87.2	4,832,166	86.6	16.0
Home equity	494,975	22,471	517,446	8.0	427,020	7.7	21.2
1-4 family mortgages	238,172	—	238,172	3.7	275,992	4.9	(13.7)
Installment	64,024	5,404	69,428	1.1	44,827	0.8	54.9
Total consumer loans	797,171	27,875	825,046	12.8	747,839	13.4	10.3
Total loans, excluding covered loans	5,894,986	533,218	6,428,204	100.0	5,580,005	100.0	15.2
Covered loans	90,875	—	90,875		134,355		(32.4)
Total loans	\$5,985,861	\$533,218	\$6,519,079		\$5,714,360		14.1

(1) Acquired loans consist of loans that were acquired in the Popular business combination that are recorded at fair value as of the acquisition date.

Total loans, excluding covered loans, of \$6.4 billion rose by \$848.2 million from December 31, 2013. Total loans, excluding acquired and covered loans, grew 7.5% annualized from December 31, 2013.

The majority of the loan growth was related to the Popular acquisition, which added \$533.2 million of loans at September 30, 2014, and well-balanced growth across the majority of categories. In addition, solid performance from our legacy sales platform concentrated within our commercial and industrial and agricultural loan categories reflects the impact of greater resource investments and expansion into certain sector-based lending areas, such as agri-business, asset-based lending, and healthcare.

During the nine months ended September 30, 2014, total consumer loans grew 10.3% from December 31, 2013. The 1-4 family mortgage portfolio reflects the sale of \$114.7 million of 1-4 family mortgage loans. Compared to December 31, 2013, the 21.2% increase in the home equity portfolio was impacted by organic growth, the purchase of \$48.7 million of high quality, shorter-duration, floating rate loans, and \$22.5 million of loans acquired in the Popular acquisition.

Commercial, Industrial, and Agricultural Loans

Commercial, industrial, and agricultural loans represent 39.7% of total loans, excluding covered loans, and totaled \$2.6 billion at September 30, 2014, an increase of \$403.3 million, or 18.7% from December 31, 2013. Loans acquired in the Popular transaction during the third quarter of 2014 contributed \$76.8 million, or 3.6%, of this growth. Our

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

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

Commercial Real Estate Loans

Commercial real estate loans represent 47.5% of total loans, excluding covered loans, and totaled \$3.0 billion at September 30, 2014 an increase of \$367.7 million, or 13.7% from December 31, 2013. Overall, growth was driven by loans acquired in the Popular transaction, which totaled \$428.5 million at September 30, 2014. This growth was partially offset by declines in the office, retail, and industrial and other commercial real estate portfolios. Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans. The repayment of commercial real estate loans depends on the successful operation of the property securing the loan or the business conducted on the property securing the loan. This category of loans may be more adversely affected by conditions in the real estate market. Management monitors and evaluates commercial real estate loans based on cash flow, collateral, geography, and risk rating criteria. The mix of properties securing the loans in our commercial real estate portfolio are balanced between owner-occupied and investor categories and represent varying types across our market footprint.

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

The following table presents commercial real estate loan detail.

Table 10

Commercial Real Estate Loans

(Dollar amounts in thousands)

	September 30, 2014	% of Total	December 31, 2013	% of Total
Office, retail, and industrial:				
Office	\$437,222	14.4	\$459,202	17.1
Retail	454,178	14.9	392,576	14.7
Industrial	531,122	17.4	501,907	18.7
Total office, retail, and industrial	1,422,522	46.7	1,353,685	50.5
Multi-family	559,689	18.4	332,873	12.4
Construction	193,445	6.3	186,197	7.0
Other commercial real estate				
Rental properties	121,573	4.0	112,887	4.2
Service stations and truck stops	71,100	2.3	83,237	3.1
Warehouses and storage	131,416	4.3	122,325	4.6
Hotels	53,187	1.7	62,451	2.3
Restaurants	76,459	2.5	79,809	3.0
Automobile dealers	33,901	1.1	37,504	1.4
Recreational	47,729	1.6	56,327	2.1
Religious	35,519	1.2	32,614	1.2
Multi-use properties	204,993	6.7	118,351	4.4
Other	95,948	3.2	101,566	3.8
Total other commercial real estate	871,825	28.6	807,071	30.1
Total commercial real estate	\$3,047,481	100.0	\$2,679,826	100.0
Owner-occupied commercial real estate loans, excluding multi-family and construction loans	\$961,962		\$933,151	
Owner-occupied as a percent of total, excluding multi-family and construction loans	41.9	%	43.2	%

Consumer Loans

Consumer loans represent 12.8% of total loans, excluding covered loans, and totaled \$825.0 million at September 30, 2014, an increase of \$77.2 million, or 10.3% from December 31, 2013. Loans acquired in the Popular transaction during the third quarter of 2014 contributed \$27.9 million, or 3.7%, of this growth. Consumer loans are centrally underwritten using a credit scoring model developed by the Fair Isaac Corporation (“FICO”). It uses a risk-based system to determine the probability that a borrower may default on financial obligations to the lender. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include loan-to-value and affordability ratios, risk-based pricing strategies, and documentation requirements. The home equity category consists mainly of revolving lines of credit secured by junior liens on owner-occupied real estate. Loan-to-value ratios on home equity loans and 1-4 family mortgages are based on the current appraised value of the collateral.

Non-performing Assets and Performing Potential Problem Loans

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

Table 11
Loan Portfolio by Performing/Non-Performing Status
(Dollar amounts in thousands)

	Total Loans	Current	Accruing 30-89 Days Past Due	90 Days Past Due	TDRs	Non-accrual
As of September 30, 2014						
Commercial and industrial	\$2,208,166	\$2,179,077	\$5,974	\$1,256	\$2,163	\$19,696
Agricultural	347,511	347,150	—	—	—	361
Commercial real estate:						
Office	437,222	428,602	867	3,766	—	3,987
Retail	454,178	444,774	975	74	416	7,939
Industrial	531,122	525,909	—	—	176	5,037
Multi-family	559,689	556,896	641	—	616	1,536
Construction	193,445	186,363	—	—	—	7,082
Other commercial real estate	871,825	859,440	3,882	150	441	7,912
Total commercial real estate	3,047,481	3,001,984	6,365	3,990	1,649	33,493
Total corporate loans	5,603,158	5,528,211	12,339	5,246	3,812	53,550
Home equity	517,446	507,314	2,959	587	752	5,834
1-4 family mortgages	238,172	232,331	1,595	126	885	3,235
Installment	69,428	66,988	428	103	—	1,909
Total consumer loans	825,046	806,633	4,982	816	1,637	10,978
Total loans, excluding covered loans	6,428,204	6,334,844	17,321	6,062	5,449	64,528
Covered loans	90,875	72,137	802	7,031	—	10,905
Total loans	\$6,519,079	\$6,406,981	\$18,123	\$13,093	\$5,449	\$75,433
As of December 31, 2013						
Commercial and industrial	\$1,830,638	\$1,805,516	\$6,424	\$393	\$6,538	\$11,767
Agricultural	321,702	321,123	60	—	—	519
Commercial real estate:						
Office	459,202	455,547	1,200	731	—	1,724
Retail	392,576	385,234	939	272	624	5,507
Industrial	501,907	481,766	337	312	9,647	9,845
Multi-family	332,873	329,669	318	—	1,038	1,848
Construction	186,197	179,877	23	—	—	6,297
Other commercial real estate	807,071	789,517	4,817	258	4,326	8,153
Total commercial real estate	2,679,826	2,621,610	7,634	1,573	15,635	33,374
Total corporate loans	4,832,166	4,748,249	14,118	1,966	22,173	45,660
Home equity	427,020	413,912	4,355	1,102	787	6,864
1-4 family mortgages	275,992	267,497	1,939	548	810	5,198
Installment	44,827	42,329	330	92	—	2,076
Total consumer loans	747,839	723,738	6,624	1,742	1,597	14,138
Total loans, excluding covered loans	5,580,005	5,471,987	20,742	3,708	23,770	59,798

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

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

Table 12

Non-Performing Assets and Past Due Loans

(Dollar amounts in thousands)

	2014		2013			
	September 30	June 30	March 31	December 31	September 30	
Non-performing assets, excluding acquired and covered loans and covered OREO ⁽¹⁾						
Non-accrual loans	\$63,858	\$66,728	\$64,217	\$59,798	\$68,170	
90 days or more past due loans	5,983	3,533	4,973	3,708	5,642	
Total non-performing loans	69,841	70,261	69,190	63,506	73,812	
Accruing TDRs	5,449	5,697	6,301	23,770	24,329	
OREO	29,165	30,331	30,026	32,473	35,616	
Total non-performing assets	\$104,455	\$106,289	\$105,517	\$119,749	\$133,757	
30-89 days past due loans	\$13,459	\$24,167	\$12,861	\$20,742	\$15,111	
Non-accrual loans to total loans	1.08	% 1.14	% 1.13	% 1.07	% 1.25	%
Non-performing loans to total loans	1.18	% 1.20	% 1.22	% 1.14	% 1.35	%
Non-performing assets to loans plus OREO	1.76	% 1.81	% 1.84	% 2.13	% 2.44	%
Non-performing acquired loans and OREO ⁽¹⁾						
Non-accrual loans	\$670	\$—	\$—	\$—	\$—	
90 days or more past due loans	79	—	—	—	—	
Total non-performing loans	749	—	—	—	—	
OREO	—	—	—	—	—	
Total non-performing assets	\$749	\$—	\$—	\$—	\$—	
30-89 days past due loans	\$3,862	\$—	\$—	\$—	\$—	
Non-performing covered loans and covered OREO ⁽¹⁾						
Non-accrual loans	\$10,905	\$13,060	\$18,004	\$20,942	\$30,856	
90 days or more past due loans	7,031	8,464	14,691	18,081	20,235	
Total non-performing loans	17,936	21,524	32,695	39,023	51,091	
OREO	9,277	9,825	7,355	8,863	10,477	
Total non-performing assets	\$27,213	\$31,349	\$40,050	\$47,886	\$61,568	
30-89 days past due loans	\$802	\$6,286	\$2,439	\$2,232	\$7,881	
Total non-performing assets						
Non-accrual loans	\$75,433	\$79,788	\$82,221	\$80,740	\$99,026	
90 days or more past due loans	13,093	11,997	19,664	21,789	25,877	
Total non-performing loans	88,526	91,785	101,885	102,529	124,903	
Accruing TDRs	5,449	5,697	6,301	23,770	24,329	
OREO	38,442	40,156	37,381	41,336	46,093	
Total non-performing assets	\$132,417	\$137,638	\$145,567	\$167,635	\$195,325	
30-89 days past due loans	\$18,123	\$30,453	\$15,300	\$22,974	\$22,992	
Non-accrual loans to total loans	1.16	% 1.34	% 1.41	% 1.41	% 1.77	%
Non-performing loans to total loans	1.36	% 1.54	% 1.75	% 1.79	% 2.23	%
Non-performing assets to loans plus OREO	2.02	% 2.30	% 2.49	% 2.91	% 3.46	%

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Due to the impact of business combination accounting and protection provided by the FDIC Agreements, acquired loans and covered loans and covered OREO are separated in this table and excluded from these metrics to provide⁽¹⁾ for improved comparability to prior periods and better perspective into asset quality trends. For a discussion of acquired and covered loans, refer to Note 1 and Note 6 of “Notes to the Condensed Consolidated Financial Statements” in Part I, Item 1 of this Form 10-Q.

Non-performing assets, excluding acquired and covered loans and covered OREO, decreased by \$15.3 million, or 12.8%, from December 31, 2013 due primarily to lower levels of accruing TDRs, which was partially offset by a rise in non-performing loans.

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Two accruing TDRs totaling \$18.8 million were returned to performing status after sustained payment performance in accordance with their modified terms, which represent market rates at the time of restructuring. Refer to the "TDRs" section below for further discussion.

TDRs

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

Table 13

TDRs by Type

(Dollar amounts in thousands)

	September 30, 2014		December 31, 2013		September 30, 2013	
	Number of Loans	Amount	Number of Loans	Amount	Number of Loans	Amount
Commercial and industrial	9	\$17,969	10	\$8,659	12	\$9,029
Agricultural	—	—	—	—	—	—
Commercial real estate:						
Office	—	—	—	—	—	—
Retail	1	416	2	624	2	626
Industrial	1	176	3	9,647	4	10,083
Multi-family	4	853	5	1,291	5	1,304
Construction	—	—	—	—	2	495
Other commercial real estate	6	627	7	4,617	7	4,726
Total commercial real estate	12	2,072	17	16,179	20	17,234
Total corporate loans	21	20,041	27	24,838	32	26,263
Home equity	18	1,265	18	1,299	14	1,068
1-4 family mortgages	11	1,120	14	1,716	14	1,735
Installment	—	—	—	—	—	—
Total consumer loans	29	2,385	32	3,015	28	2,803
Total TDRs	50	\$22,426	59	\$27,853	60	\$29,066
Accruing TDRs	30	\$5,449	39	\$23,770	37	\$24,329
Non-accrual TDRs	20	16,977	20	4,083	23	4,737
Total TDRs	50	\$22,426	59	\$27,853	60	\$29,066
Year-to-date charge-offs on TDRs		\$8,345		\$1,880		\$1,850
Specific reserves related to TDRs		2,625		1,952		2,024

TDRs totaled \$22.4 million at September 30, 2014, decreasing \$5.4 million from December 31, 2013.

Accruing TDRs declined \$18.3 million from December 31, 2013 driven primarily by the return of two TDRs totaling \$18.8 million to performing status during the first quarter of 2014 after sustained payment performance in accordance with their modified terms, which represent market rates at the time of restructuring. This reduction was partially offset by the addition of a corporate loan relationship totaling \$2.0 million that was upgraded to accruing TDR status.

At September 30, 2014, non-accrual TDRs totaled \$17.0 million compared to \$4.1 million at December 31, 2013. The increase was driven primarily by the restructure of one non-accrual credit totaling \$15.5 million, net of related charge-offs, during the third quarter of 2014. TDRs are reported as non-accrual if they are not performing in accordance with their modified terms or they have not yet exhibited sufficient performance under their modified

terms.

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Performing Potential Problem Loans

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

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

	September 30, 2014			December 31, 2013			
	Special Mention ⁽¹⁾	Substandard ⁽²⁾	Total ⁽³⁾	Special Mention ⁽¹⁾	Substandard ⁽²⁾	Total ⁽³⁾	
Commercial and industrial	\$66,429	\$25,425	\$91,854	\$23,679	\$14,135	\$37,814	
Agricultural	299	—	299	344	—	344	
Commercial real estate:							
Office, retail, and industrial	28,411	32,723	61,134	27,871	23,538	51,409	
Multi-family	5,502	6,818	12,320	2,794	499	3,293	
Construction	7,229	16,607	23,836	8,309	17,642	25,951	
Other commercial real estate	22,528	24,410	46,938	14,567	22,576	37,143	
Total commercial real estate	63,670	80,558	144,228	53,541	64,255	117,796	
Total performing potential problem loans	130,398	105,983	236,381	77,564	78,390	155,954	
Less: acquired performing potential problem loans	3,855	38,234	42,089	—	—	—	
Total performing potential problem loans, excluding acquired loans	\$126,543	\$67,749	\$194,292	\$77,564	\$78,390	\$155,954	
Performing potential problem loans to corporate loans	2.33	% 1.89	% 4.22	% 1.61	% 1.62	% 3.23	%
Performing potential problem loans to corporate loans, excluding acquired loans	2.48	% 1.33	% 3.81	% 1.61	% 1.62	% 3.23	%

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

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

(3) Total performing potential problem loans excludes accruing TDRs of \$3.5 million as of September 30, 2014 and \$2.8 million as of December 31, 2013.

Performing potential problem loans totaled \$236.4 million as of September 30, 2014 compared to \$156.0 million as of December 31, 2013. This increase was impacted by the Popular acquisition, which added \$42.1 million of performing potential problem loans. Acquired loans are recorded at fair value, which incorporates credit risk, at the date of acquisition.

Performing potential problem loans, excluding acquired loans, were 3.81% of corporate loans at September 30, 2014 compared to 3.23% at December 31, 2013. This level reflects a greater proportion of loans classified as special mention compared to December 31, 2013. Special mention loans, excluding acquired loans, increased by \$49.0 million from December 31, 2013, driven primarily by the downgrade of two corporate loan relationships totaling \$37.5 million for which management has specific monitoring plans.

OREO

OREO consists of properties acquired as the result of borrower defaults on loans. OREO, excluding covered OREO, was \$29.2 million at September 30, 2014, decreasing \$3.3 million from December 31, 2013.

Table 15

OREO by Type

(Dollar amounts in thousands)

	September 30, 2014	December 31, 2013	September 30, 2013
Single-family homes	\$2,106	\$2,257	\$3,028
Land parcels:			
Raw land	3,145	4,037	4,540
Commercial lots	10,941	11,649	11,955
Single-family lots	1,742	3,101	3,105
Total land parcels	15,828	18,787	19,600
Multi-family units	933	346	845
Commercial properties	10,298	11,083	12,143
Total OREO, excluding covered OREO	29,165	32,473	35,616
Covered OREO	9,277	8,863	10,477
Total OREO	\$38,442	\$41,336	\$46,093

OREO Activity

A rollforward of OREO balances for the nine months ended September 30, 2014 and 2013 is presented in the following table.

Table 16

OREO Rollforward

(Dollar amounts in thousands)

	Nine Months Ended September 30, 2014			September 30, 2013		
	OREO	Covered OREO	Total	OREO	Covered OREO	Total
Beginning balance	\$32,473	\$8,863	\$41,336	\$39,953	\$13,123	\$53,076
Transfers from loans	4,749	8,528	13,277	10,775	5,102	15,877
Proceeds from sales	(6,047)	(8,246)	(14,293)	(13,151)	(7,564)	(20,715)
Gains (losses) on sales of OREO	703	177	880	(1,333)	17	(1,316)
OREO valuation adjustments	(2,713)	(45)	(2,758)	(628)	(201)	(829)
Ending Balance	\$29,165	\$9,277	\$38,442	\$35,616	\$10,477	\$46,093

Allowance for Credit Losses

Methodology for the Allowance for Credit Losses

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

Acquired loans are recorded at fair value, which incorporates credit risk, at the date of acquisition. No allowance for credit losses is recorded on the acquisition date. As the acquisition adjustment is accreted into income over future periods, an allowance for credit losses will be established as necessary to reflect credit deterioration.

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

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

An allowance for credit losses is established on legacy loans, which consist of loans originated by the Bank, acquired loans, and covered loans. Additional discussion regarding acquired and covered loans is discussed in Note 6 of "Notes to the Condensed Consolidated Financial Statements" in Part I, Item 1 of this Form 10-Q. The following table provides additional details related to the legacy, covered, and acquired components of the allowance for credit losses and the remaining acquisition adjustment associated with acquired loans for the quarter ended September 30, 2014.

Table 17
Allowance for Credit Losses and Acquisition Adjustment
(Dollar amounts in thousands)

	Legacy and Covered Loans	Acquired Loans	Total
Quarter ended September 30, 2014			
Beginning balance	\$79,942	\$—	\$79,942
Net charge-offs	(15,947	) —	(15,947
Provision for loan and covered loan losses	10,727	—	10,727
Ending balance	\$74,722	\$—	\$74,722
Total loans	\$5,985,861	\$533,218	\$6,519,079
Remaining acquisition adjustment	N/A	13,598	13,598
Allowance for credit losses as a percent of total loans	1.25	% N/A	1.15
Remaining acquisition adjustment as a percent of acquired loans	N/A	2.55	% N/A

N/A - Not applicable.

Excluding acquired loans, the total allowance for credit losses to total loans is 1.25%. Accretion of the acquisition adjustment into interest income totaled \$500,000 during the third quarter of 2014, resulting in a remaining acquisition

adjustment as a percent of acquired loans of 2.55%.

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Table 18
 Allowance for Credit Losses
 and Summary of Credit Loss Experience
 (Dollar amounts in thousands)

	Quarters Ended				
	2014		March 31	2013	
	September 30	June 30		December 31	September 30
Change in allowance for credit losses					
Beginning balance	\$79,942	\$82,248	\$87,121	\$93,214	\$96,976
Loan charge-offs:					
Commercial, industrial, and agricultural	9,763	2,099	3,680	3,084	2,719
Office, retail, and industrial	2,514	3,511	1,083	1,042	987
Multi-family	26	267	90	539	112
Construction	157	234	661	31	470
Other commercial real estate	1,363	561	1,771	813	889
Consumer	3,148	1,829	2,028	2,045	2,482
Total loan charge-offs	16,971	8,501	9,313	7,554	7,659
Recoveries of loan charge-offs:					
Commercial, industrial, and agricultural	716	259	2,160	614	521
Office, retail, and industrial	55	290	58	160	31
Multi-family	—	2	1	549	—
Construction	—	2	158	965	60
Other commercial real estate	108	89	144	37	250
Consumer	150	214	138	177	374
Total recoveries of loan charge-offs	1,029	856	2,659	2,502	1,236
Net loan charge-offs, excluding covered loan charge-offs	15,942	7,645	6,654	5,052	6,423
Net covered loan charge-offs (recoveries)	5	2	(340)	271	1,629
Net loan and covered loan charge-offs	15,947	7,647	6,314	5,323	8,052
Provision for loan and covered loan losses:					
Provision for loan losses	11,416	7,425	2,911	226	4,466
Provision for covered loan losses	(689)	(2,084)	(1,470)	(226)	304
Total provision for loan and covered loan losses	10,727	5,341	1,441	—	4,770
Reduction in reserve for unfunded commitments ⁽¹⁾	—	—	—	(770)	(480)
Total provision for loan and covered loan losses and other	10,727	5,341	1,441	(770)	4,290
Ending balance	\$74,722	\$79,942	\$82,248	\$87,121	\$93,214

⁽¹⁾ Included in other noninterest expense in the Consolidated Statements of Income.

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	Quarters Ended			2013		
	2014 September 30	June 30	March 31	December 31	September 30	
Allowance for credit losses						
Allowance for loan losses	\$64,457	\$68,983	\$69,203	\$72,946	\$77,772	
Allowance for covered loan losses	8,649	9,343	11,429	12,559	13,056	
Total allowance for loan and covered loan losses	73,106	78,326	80,632	85,505	90,828	
Reserve for unfunded commitments	1,616	1,616	1,616	1,616	2,386	
Total allowance for credit losses	\$74,722	\$79,942	\$82,248	\$87,121	\$93,214	
Amounts and ratios, excluding acquired loans, including covered loans ⁽¹⁾						
Average loans	\$5,980,337	\$5,891,127	\$5,706,880	\$5,658,756	\$5,539,776	
Net loan charge-offs to average loans, annualized	1.06	% 0.52	% 0.45	% 0.37	% 0.58	%
Allowance for credit losses at end of period as a percent of:						
Total loans	1.25	% 1.34	% 1.41	% 1.52	% 1.66	%
Non-accrual loans	99.95	% 100.19	% 100.03	% 107.90	% 94.13	%
Non-performing loans	85.13	% 87.10	% 80.73	% 84.97	% 74.63	%

(1) Due to the impact of business combination accounting, acquired loans are excluded from these metrics to provide for improved comparability to prior periods and better perspective into asset quality trends.

Activity in the Allowance for Credit Losses

The allowance for credit losses was \$74.7 million as of September 30, 2014, a decline of \$12.4 million from December 31, 2013. The allowance for credit losses was 1.25% of total loans, excluding acquired loans, including covered loans, at September 30, 2014 compared to 1.52% at December 31, 2013.

Net loan charge-offs, excluding covered loan charge-offs, increased by \$10.9 million from the fourth quarter of 2013, and primarily relates to the recognition of a \$7.5 million loss attributable to a longstanding commercial borrowing relationship. This loss resulted from reported accounting irregularities and the resulting impact on the borrower's adherence to customary debt covenants. The Company is aggressively pursuing all appropriate collection and other remedies.

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

FUNDING AND LIQUIDITY MANAGEMENT

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

Table 19
Funding Sources – Average Balances
(Dollar amounts in thousands)

	Quarters Ended			Third Quarter 2014 % Change From		
	September 30, 2014	December 31, 2013	September 30, 2013	Fourth Quarter 2013	Third Quarter 2013	
Demand deposits	\$2,208,450	\$1,956,570	\$1,975,797	12.9	%	11.8 %
Savings deposits	1,231,700	1,126,737	1,127,970	9.3	%	9.2 %
NOW accounts	1,261,522	1,195,471	1,175,926	5.5	%	7.3 %
Money market accounts	1,413,753	1,356,383	1,343,263	4.2	%	5.2 %
Transactional deposits	6,115,425	5,635,161	5,622,956	8.5	%	8.8 %
Time deposits	1,209,935	1,218,450	1,272,670	(0.7)	)%	(4.9 %) %
Brokered deposits	16,090	16,067	16,076	0.1	%	0.1 %
Total time deposits	1,226,025	1,234,517	1,288,746	(0.7)	)%	(4.9 %) %
Total deposits	7,341,450	6,869,678	6,911,702	6.9	%	6.2 %
Securities sold under agreements to repurchase	101,348	99,207	89,029	2.2	%	13.8 %
Federal funds purchased	326	—	22	100.0	%	N/M
FHLB advances	—	114,554	114,562	(100.0)	)%	(100.0 %) %
Total borrowed funds	101,674	213,761	203,613	(52.4)	)%	(50.1 %) %
Senior and subordinated debt	191,013	207,162	214,860	(7.8)	)%	(11.1 %) %
Total funding sources	\$7,634,137	\$7,290,601	\$7,330,175	4.7	%	4.1 %
Average interest rate paid on borrowed funds	0.04	% 0.72	% 0.76	%		
Weighted-average maturity of FHLB advances	N/M	29.3 months	32.6 months			
Weighted-average interest rate of FHLB advances	N/M	1.34	% 1.34	%		

N/M - Not meaningful.

Average funding sources for the third quarter of 2014 increased \$343.5 million from the fourth quarter of 2013 and \$304.0 million from the third quarter of 2013. Compared to both prior periods presented, the rise in transactional deposits was driven primarily by deposits assumed in the Popular transaction. The reduction in borrowed funds resulted from the prepayment of \$114.6 million in FHLB advances with a weighted-average rate of 1.33% during the second quarter of 2014. The reduction in average senior and subordinated debt compared to both prior quarters presented was due to the repurchase and retirement of \$24.0 million of junior subordinated debentures with a rate of 6.95% during the fourth quarter of 2013.

Table 20
Borrowed Funds
(Dollar amounts in thousands)

	September 30, 2014		September 30, 2013	
	Amount	Weighted-Average Rate (%)	Amount	Weighted-Average Rate (%)
At period-end:				
Securities sold under agreements to repurchase	\$ 107,877	0.04	\$ 97,500	0.03
Federal funds purchased	25,000	—	—	—
FHLB advances	—	—	114,558	1.34
Total borrowed funds	\$ 132,877	0.04	\$ 212,058	0.74
Average for the year-to-date period:				
Securities sold under agreements to repurchase	\$ 104,468	0.03	\$ 88,088	0.03
Federal funds purchased	110	—	7	—
FHLB advances	57,903	1.24	114,569	1.40
Total borrowed funds	\$ 162,481	0.46	\$ 202,664	0.80
Maximum amount outstanding at the end of any day during the period:				
Securities sold under agreements to repurchase	\$ 117,772		\$ 106,170	
Federal funds purchased	25,000		—	
FHLB advances	114,551		114,581	

Average borrowed funds totaled \$162.5 million for the first nine months of 2014 decreasing 19.8% compared to the same period in 2013 due to the prepayment of \$114.6 million of FHLB advances during the second quarter of 2014. This decline was partially offset by higher levels of securities sold under agreements to repurchase.

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

MANAGEMENT OF CAPITAL

Capital Measurements

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

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

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

Table 21
Capital Measurements
(Dollar amounts in thousands)

	September 30, 2014	December 31, 2013	Regulatory Minimum For Well- Capitalized	Excess Over Required Minimums at September 30, 2014	
Bank regulatory capital ratios:					
Total capital to risk-weighted assets	11.70	% 13.86	% 10.00	% 17	% \$125,043
Tier 1 capital to risk-weighted assets	10.69	% 12.61	% 6.00	% 78	% \$344,057
Tier 1 leverage to average assets	9.42	% 10.24	% 5.00	% 88	% \$368,276
Company regulatory capital ratios ⁽¹⁾ :					
Total capital to risk-weighted assets	10.94	% 12.39	% N/A	N/A	N/A
Tier 1 capital to risk-weighted assets	9.86	% 10.91	% N/A	N/A	N/A
Tier 1 leverage to average assets	8.93	% 9.18	% N/A	N/A	N/A
Company tier 1 common capital to risk-weighted assets ⁽¹⁾⁽²⁾	9.38	% 10.37	% N/A	N/A	N/A
Reconciliation of Company capital components to GAAP:					
Total stockholders' equity	\$1,049,676	\$1,001,442			
Goodwill and other intangible assets	(322,664)	(276,366)			
Tangible common equity	727,012	725,076			
Accumulated other comprehensive loss	18,852	26,792			
Tangible common equity, excluding accumulated other comprehensive loss	\$745,864	\$751,868			
Total assets	\$9,096,351	\$8,253,407			
Goodwill and other intangible assets	(322,664)	(276,366)			
Tangible assets	\$8,773,687	\$7,977,041			
Risk-weighted assets	\$7,636,326	\$6,794,666			
Company tangible common equity ratios ⁽¹⁾⁽³⁾ :					
Tangible common equity to tangible assets	8.29	% 9.09	% N/A	N/A	N/A
Tangible common equity, excluding accumulated other comprehensive loss, to tangible assets	8.50	% 9.43	% N/A	N/A	N/A
Tangible common equity to risk-weighted assets	9.52	% 10.67	% N/A	N/A	N/A

N/A - Not applicable.

⁽¹⁾ Ratio is not subject to formal Federal Reserve regulatory guidance.

⁽²⁾ Excludes the impact of trust-preferred securities.

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

Overall, the Company's capital ratios decreased compared to December 31, 2013. The Popular acquisition drove this decrease due to the addition of risk-weighted assets and average assets, including goodwill and other intangible assets,

in the third quarter of 2014. The Bank's regulatory ratios exceeded all regulatory mandated ratios for characterization as "well-capitalized" as of September 30, 2014.

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

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Basel III Capital Rules

In July of 2013, the Company and the Bank's primary federal regulator, the Federal Reserve, published final rules establishing a new comprehensive capital framework for U.S. banking organizations. The Basel III Capital Rules are discussed in the "Supervision and Regulation" section in Item 1, "Business" in the Company's 2013 10-K.

Management believes that as of September 30, 2014 the Company and the Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect.

Dividends

The Board of Directors approved a quarterly cash dividend of \$0.08 per common share during the third quarter of 2014, which follows a dividend increase from \$0.07 to \$0.08 per common share during the second quarter of 2014.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

Net Interest Income Sensitivity

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

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

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

Interest-earning assets consist of short and long-term products. As of September 30, 2014, 50% of the loan portfolio consisted of fixed rate loans and 50% were floating rate loans. Investments, consisting of securities and interest-bearing deposits, are more heavily weighted toward fixed rate securities at 61% of the total compared to 39% for floating rate interest-bearing deposits in other banks. Fixed rate loans are most sensitive to the 3-5 year portion of the yield curve and the Bank limits its loans with maturities that extend beyond 5 years. The majority of floating rate loans are indexed to the short-term Prime or LIBOR rates. The amount of floating rate loans with interest rate floors was \$681.1 million, or 26%, of the floating rate loan portfolio as of September 30, 2014, compared to \$807.3 million, or 34%, of the floating rate loan portfolio as of December 31, 2013. On the liability side of the balance sheet, 83.5% of deposits are demand deposits or interest-bearing transactional deposits, which either do not pay interest or the interest rates are expected to rise at a slower pace than short-term interest rates.

Analysis of Net Interest Income Sensitivity

(Dollar amounts in thousands)

	Immediate Change in Rates			
	+300	+200	+100	-100
September 30, 2014:				
Dollar change	\$44,567	\$28,614	\$13,384	\$(10,265)
Percent change	15.8	% 10.1	% 4.7	% (3.6)
December 31, 2013:				
Dollar change	\$45,209	\$28,307	\$11,925	\$(11,791)
Percent change	17.3	% 10.8	% 4.6	% (4.5)

The sensitivity of estimated net interest income to an instantaneous parallel shift in interest rates is reflected as both dollar and percentage changes. For example, this table illustrates that an instantaneous 200 basis point rise in interest rates as of September 30, 2014 would increase net interest income by \$28.6 million, or 10.1%, over the next twelve months compared to no change in interest rates. This same measure was \$28.3 million, or 10.8%, as of December 31, 2013, which suggests that the Company was slightly less sensitive to rising rates at September 30, 2014 compared to December 31, 2013.

During the nine months ended September 30, 2014, the increase in floating rate loan balances were funded by an increase in core deposits, which are less rate sensitive. Overall, this increase in rate sensitive assets was offset by the prepayment of \$114.6 million of FHLB advances at fixed rates and the hedging of \$325.0 million of certain corporate variable rate loans using interest rate swaps through which we receive fixed amounts and pay variable amounts. Fixed rate loans also increased due to the Popular acquisition, which added a greater proportion of higher yielding, fixed rate loans; however, this effect was mostly offset by a decrease in investments as cash flows have not been reinvested in the investment security portfolio during the nine months ended September 30, 2014. While net interest income is projected to decline in a decreasing interest rate environment, we believe the risk of a significant and sustained decrease in interest rates is minimal.

ITEM 4. CONTROLS AND PROCEDURES

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

or cash flows.

ITEM 1A. RISK FACTORS

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

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

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

Issuer Purchases of Equity Securities

	Total Number of Shares Purchased ⁽¹⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program	Maximum Number of Shares that May Yet Be Purchased Under the Plan or Program
July 1 – July 31, 2014	1,553	\$16.75	—	2,494,747
August 1 – August 31, 2014	—	—	—	2,494,747
September 1 – September 30, 2014	—	—	—	2,494,747
Total	1,553	\$16.75	—	

Consists of shares acquired pursuant to the Company's share-based compensation plans and not the Company's stock repurchase program. Under the terms of these plans, the Company accepts shares of Common Stock from

⁽¹⁾ option holders if they elect to surrender previously owned shares upon exercise to cover the exercise price of the stock options or, in the case of restricted shares of Common Stock, the withholding of shares to satisfy tax withholding obligations associated with the vesting of restricted shares.

ITEM 6. EXHIBITS

Exhibit Number	Description of Documents
3.1	Restated Certificate of Incorporation of the Company is incorporated herein by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2009.
3.2	Certificate of Amendment of Restated Certificate of Incorporation of the Company is incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 4, 2014.
3.3	Restated By-Laws of the Company are incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 28, 2012.
11	Statement re: Computation of Per Share Earnings - The computation of basic and diluted earnings per common share is included in Note 8 of the Company's Notes to the Condensed Consolidated Financial Statements included in "ITEM 1. FINANCIAL STATEMENTS" of this document.
15	Acknowledgment of Independent Registered Public Accounting Firm.
31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 ⁽¹⁾	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 ⁽¹⁾	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99	Report of Independent Registered Public Accounting Firm.
101	Interactive Data File.

⁽¹⁾ Furnished, not filed.

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SIGNATURES

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

First Midwest Bancorp, Inc.

/s/ PAUL F. CLEMENS

Paul F. Clemens

Executive Vice President and Chief Financial Officer*

Date: November 7, 2014

* Duly authorized to sign on behalf of the registrant.

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