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

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

FORM 10-Q
(Mark One)

[X]	Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended June 30, 2014
	or
[ ]	Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from _________ to __________.

Commission File Number 0-10967

FIRST MIDWEST BANCORP, INC.
(Exact name of registrant as specified in its charter)

Delaware	36-3161078
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

One Pierce Place, Suite 1500
Itasca, Illinois 60143-9768
(Address of principal executive offices) (zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] 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 [X] 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 [X]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	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 [X].

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

FIRST MIDWEST BANCORP, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION (Unaudited)

ITEM 1. FINANCIAL STATEMENTS

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Amounts in thousands, except per share data)

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

	June 30, 2014		December 31, 2013	
	Preferred Shares	Common Shares	Preferred Shares	Common Shares
Par Value	$—	$0.01	$—	$0.01

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollar amounts in thousands)
(Unaudited)

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

	Accumulated 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	(1,138)	—	6,499	5,361
Balance at June 30, 2013	$(23)	$—	$(10,276)	$(10,299)
Balance at December 31, 2013	$(20,419)	$—	$(6,373)	$(26,792)
Other comprehensive income (loss)	11,638	(117)	—	11,521
Balance at June 30, 2014	$(8,781)	$(117)	$(6,373)	$(15,271)

See accompanying notes to the unaudited condensed consolidated financial statements.

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Amounts in thousands, except per share data)
(Unaudited)

	Common 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	—	—	—	30,818	5,361	—	36,179
Common dividends declared ($0.05 per common share)	—	—	—	(3,755)	—	—	(3,755)
Share-based compensation expense	—	—	2,854	—	—	—	2,854
Restricted stock activity	224	—	(9,648)	—	—	8,126	(1,522)
Treasury stock (purchased for) issued to benefit plans	(1)	—	(54)	—	—	58	4
Balance at June 30, 2013	75,063	$858	$411,470	$813,516	$(10,299)	$(240,892)	$974,653
Balance at December 31, 2013	75,071	$858	$414,293	$853,740	$(26,792)	$(240,657)	$1,001,442
Comprehensive income	—	—	—	36,164	11,521	—	47,685
Common dividends declared ($0.15 per common share)	—	—	—	(11,297)	—	—	(11,297)
Share-based compensation expense	—	—	3,226	—	—	—	3,226
Restricted stock activity	194	—	(9,501)	—	—	7,625	(1,876)
Treasury stock issued to (purchased for) benefit plans	8	—	(123)	—	—	381	258
Balance at June 30, 2014	75,273	$858	$407,895	$878,607	$(15,271)	$(232,651)	$1,039,438

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

Purchased Impaired Loans – Purchased impaired loans include acquired loans that had evidence of credit deterioration since origination and it was probable at acquisition that the Company would not collect all contractually required principal and interest payments. Evidence of credit deterioration was evaluated using various indicators, such as past due and non-accrual status. Other key considerations included past performance of the institutions' credit underwriting standards, completeness and accuracy of credit files, maintenance of risk ratings, and age of appraisals. Lease and revolving loans do not qualify to be accounted for as purchased impaired loans. No allowance for credit losses is recorded on these loans at the acquisition date. Purchased impaired loans are recorded at fair value, and are accounted for prospectively based on estimates of expected cash flows. To estimate the fair value, the Company generally aggregates purchased consumer loans and certain smaller balance commercial loans into pools of loans with common risk characteristics, such as delinquency status, credit score, and internal risk rating. The fair values of larger balance commercial loans are estimated on an individual basis. Expected future cash flows in excess of the fair value of loans at the purchase date ("accretable yield") are recorded as interest income over the life of the loans if the timing and amount of the future cash flows can be reasonably estimated. The non-accretable yield represents the difference between contractually required payments and the cash flows expected to be collected at acquisition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2. RECENT EVENTS

Acquisitions

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

Equity Matters

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

Recent Accounting Pronouncements

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

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

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

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

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

3. SECURITIES

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

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

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

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

Securities Portfolio
(Dollar amounts in thousands)

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

Remaining Contractual Maturity of Securities
(Dollar amounts in thousands)

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

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

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

Securities Gains (Losses)
(Dollar amounts in thousands)

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

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

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

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

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

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

	Quarters Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Beginning balance	$32,450	$38,803	$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	—	—	—	—
Reduction for sales of securities [(2)]	(8,570)	(6,750)	(8,570)	(6,750)
Ending balance	$23,880	$32,053	$23,880	$32,053

(1) Included in net securities gains in the Condensed Consolidated Statements of Income.

(2) During the second quarter of 2014, one CDO with a carrying value of $1.3 million was sold. In addition, one CDO with a carrying value of zero was sold during the second quarter of 2013. These CDOs had OTTI of $8.6 million and $6.8 million, respectively, that were previously recognized in earnings.

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

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

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

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

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

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

4. LOANS

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

Loan Portfolio
(Dollar amounts in thousands)

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

[1] For information on covered loans, refer to Note 5, “Acquired Loans.”

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

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

Loan Sales

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

Loan Sales
(Dollar amounts in thousands)

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

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

5. ACQUIRED LOANS

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

Acquired Loans
(Dollar amounts in thousands)

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

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

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

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

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

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

Changes in Accretable Yield
(Dollar amounts in thousands)

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

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

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

Past Due and Non-accrual Loans

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

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

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

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

Allowance for Credit Losses

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

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

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

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

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

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

	Loans				Allowance for Credit Losses			
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Purchased Impaired	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Purchased Impaired	Total
June 30, 2014								
Commercial, industrial, and agricultural	$21,726	$2,380,505	$1,413	$2,403,644	$2,539	$ 26,655	$—	$29,194
Commercial real estate:								
Office, retail, and industrial	15,605	1,296,796	—	1,312,401	1,576	10,255	—	11,831
Multi-family	1,169	349,129	132	350,430	176	1,857	15	2,048
Construction	4,725	190,384	—	195,109	373	4,512	—	4,885
Other commercial real estate	5,748	789,203	3,373	798,324	913	7,672	—	8,585
Total commercial real estate	27,247	2,625,512	3,505	2,656,264	3,038	24,296	15	27,349
Total corporate loans	48,973	5,006,017	4,918	5,059,908	5,577	50,951	15	56,543
Consumer	—	774,553	8,996	783,549	—	11,887	553	12,440
Total loans, excluding covered loans	48,973	5,780,570	13,914	5,843,457	5,577	62,838	568	68,983
Covered loans:								
Purchased impaired loans	—	—	75,864	75,864	—	—	8,743	8,743
Other loans	—	29,003	—	29,003	—	600	—	600
Total covered loans	—	29,003	75,864	104,867	—	600	8,743	9,343
Reserve for unfunded commitments	—	—	—	—	—	1,616	—	1,616
Total loans	$48,973	$5,809,573	$89,778	$5,948,324	$5,577	$ 65,054	$9,311	$79,942
December 31, 2013								
Commercial, 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
Covered loans:								
Purchased impaired loans	—	—	103,525	103,525	—	—	11,857	11,857
Other loans	—	30,830	—	30,830	—	702	—	702
Total covered loans	—	30,830	103,525	134,355	—	702	11,857	12,559
Reserve for unfunded commitments	—	—	—	—	—	1,616	—	1,616
Total loans	$55,832	$5,539,395	$119,133	$5,714,360	$5,160	$ 70,104	$11,857	$87,121

Loans Individually Evaluated for Impairment

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

Impaired Loans Individually Evaluated by Class
(Dollar amounts in thousands)

	June 30, 2014 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	$3,381	$18,345	$38,524	$2,539	$10,047	$3,131	$25,887	$4,046
Agricultural	—	—	—	—	—	—	—	—
Commercial real estate:								
Office, retail, and industrial	12,943	2,662	24,416	1,576	23,872	2,476	35,868	214
Multi-family	668	501	1,270	176	1,098	198	1,621	18
Construction	3,552	1,173	6,121	373	4,586	1,126	10,037	178
Other commercial real estate	2,996	2,752	8,891	913	7,553	1,745	11,335	704
Total commercial real estate	20,159	7,088	40,698	3,038	37,109	5,545	58,861	1,114
Total impaired loans individually evaluated for impairment	$23,540	$25,433	$79,222	$5,577	$47,156	$8,676	$84,748	$5,160

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

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

	Quarters Ended June 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized [(1)]	Average Recorded Investment	Interest Income Recognized [(1)]
Commercial and industrial	$14,581	$29	$25,757	$1
Agricultural	—	—	—	—
Commercial real estate:				
Office, retail, and industrial	20,098	6	23,662	6
Multi-family	1,424	2	1,009	—
Construction	4,788	—	6,397	—
Other commercial real estate	6,393	107	13,762	5
Total commercial real estate	32,703	115	44,830	11
Total impaired loans	$47,284	$144	$70,587	$12

	Six Months Ended June 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized [(1)]	Average Recorded Investment	Interest Income Recognized [(1)]
Commercial and industrial	$14,113	$147	$24,429	$3
Agricultural	—	—	—	—
Commercial real estate:				
Office, retail, and industrial	22,181	147	22,316	10
Multi-family	1,381	2	845	—
Construction	5,096	—	5,850	—
Other commercial real estate	7,361	115	13,353	8
Total commercial real estate	36,019	264	42,364	18
Total impaired loans	$50,132	$411	$66,793	$21

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

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

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

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

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

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

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

TDRs

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

TDRs by Class
(Dollar amounts in thousands)

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

(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 no specific reserves related to TDRs as of June 30, 2014 and there were $2.0 million in specific reserves related to TDRs as of December 31, 2013.

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

Loans Restructured During the Period
(Dollar amounts in thousands)

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

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

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

	Quarters Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
	Number 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	—	—	1	198	—	—	3	354
Total	—	$—	1	$198	2	$125	4	$704

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

TDR Rollforward
(Dollar amounts in thousands)

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

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

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

7. EARNINGS PER COMMON SHARE

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

Basic and Diluted Earnings per Common Share
(Amounts in thousands, except per share data)

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

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

8. INCOME TAXES

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

Income Tax Expense
(Dollar amounts in thousands)

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

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

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

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

9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

Fair Value Hedges

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

Fair Value Hedges
(Dollar amounts in thousands)

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

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

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

Cash Flow Hedges

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

Cash Flow Hedges
(Dollar amounts in thousands)

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

The effective portion of gains or losses on cash flow hedges is recorded in accumulated other comprehensive income on an after-tax basis and is subsequently reclassified to interest income or expense in the period that the forecasted hedge impacts earnings. Hedge ineffectiveness is determined using a regression analysis at the inception of the hedge relationship and on an ongoing basis. For the quarter ended June 30, 2014, there were no gains or losses related to cash flow hedge ineffectiveness. As of June 30, 2014, the Company estimates that $1.8 million will be reclassified from accumulated other comprehensive income as an increase to interest income over the next twelve months.

Other Derivative Instruments

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

Other Derivative Instruments
(Dollar amounts in thousands)

	June 30, 2014	December 31, 2013
Gross notional amount outstanding	$350,669	$256,638
Derivative asset fair value	5,019	2,235
Derivative liability fair value	(5,019)	(2,235)
Fair value of assets needed to settle derivative transactions [1]	5,089	1,305

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

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

Credit Risk

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

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

Offsetting Derivatives
(Dollar amounts in thousands)

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

[1] Included in other assets or other liabilities in the Consolidated Statements of Financial Condition.

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

10. COMMITMENTS, GUARANTEES, AND CONTINGENT LIABILITIES

Credit Commitments and Guarantees

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

Contractual or Notional Amounts of Financial Instruments
(Dollar amounts in thousands)

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

Legal Proceedings

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

11. FAIR VALUE

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

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

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

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Observable inputs other than level 1 prices, such as quoted prices for similar instruments, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These inputs require significant management judgment or estimation, some of which use model-based techniques and may be internally developed.

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

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

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

Recurring Fair Value Measurements
(Dollar amounts in thousands)

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

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

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

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

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

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

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

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

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

	Quarters Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Beginning balance	$21,666	$12,924	$18,309	$12,129
Change in other comprehensive income (loss) [1]	(1,721)	1,993	1,636	2,788
Purchases, sales, issuances, settlements, and paydowns [2]	(1,509)	—	(1,509)	—
Ending balance	$18,436	$14,917		