

OLD NATIONAL BANCORP /IN/
Form 10-Q
August 01, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

**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 1-15817

OLD NATIONAL BANCORP

(Exact name of Registrant as specified in its charter)

INDIANA
(State or other jurisdiction of
incorporation or organization)

35-1539838
(I.R.S. Employer
Identification No.)

One Main Street

Evansville, Indiana
(Address of principal executive offices)

47708
(Zip Code)

(800) 731-2265

(Registrant's telephone number, including area code)

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 the filing requirements for at least the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (s232.405 of this chapter) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Emerging growth company

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock. The registrant has one class of common stock (no par value) with 152,351,000 shares outstanding at June 30, 2018.

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GLOSSARY OF ABBREVIATIONS AND ACRONYMS

As used in this report, references to Old National, we, our, us, and similar terms refer to the consolidated entity consisting of Old National Bancorp and its wholly-owned affiliates. Old National Bancorp refers solely to the parent holding company, and Old National Bank refers to Old National's bank subsidiary.

The acronyms and abbreviations identified below are used in the Notes to Consolidated Financial Statements (Unaudited) as well as in the Management's Discussion and Analysis of Financial Condition and Results of Operations. You may find it helpful to refer to this page as you read this report.

Anchor (MN): Anchor Bancorp, Inc.

Anchor Bank (MN): Anchor Bank, N.A.

Anchor (WI): Anchor BanCorp Wisconsin Inc.

AnchorBank (WI): AnchorBank, fsb

AOCI: accumulated other comprehensive income (loss)

AQR: asset quality rating

ASC: Accounting Standards Codification

ASU: Accounting Standards Update

ATM: automated teller machine

Common Stock: Old National Bancorp common stock, without par value

CRreED: Indiana Community Revitalization Enhancement District Tax Credit

DTI: debt-to-income

Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act

EITF: Emerging Issues Task Force

FASB: Financial Accounting Standards Board

FDIC: Federal Deposit Insurance Corporation

FHLB: Federal Home Loan Bank

FHTC: Federal Historic Tax Credit

FICO: Fair Isaac Corporation

GAAP: generally accepted accounting principles in the United States

Klein: Klein Financial, Inc.

LGD: loss given default

LIBOR: London Interbank Offered Rate

LIHTC: Low Income Housing Tax Credit

LTV: loan-to-value

N/A: not applicable

N/M: not meaningful

NASDAQ: The NASDAQ Stock Market LLC

NOW: negotiable order of withdrawal

OTTI: other-than-temporary impairment

PCI: purchased credit impaired

PD: probability of default

Renewable Energy: investment tax credits for solar projects

SAB: Staff Accounting Bulletin

SEC: Securities and Exchange Commission

TBA: to be announced

TDR: troubled debt restructuring

Table of Contents**OLD NATIONAL BANCORP****CONSOLIDATED BALANCE SHEETS**

(dollars and shares in thousands, except per share data)	June 30, 2018 (unaudited)	December 31, 2017	June 30, 2017 (unaudited)
Assets			
Cash and due from banks	\$ 219,626	\$ 222,753	\$ 230,809
Money market and other interest-earning investments	54,248	67,679	31,932
Total cash and cash equivalents	273,874	290,432	262,741
Trading securities, at fair value	5,596	5,584	5,235
Investment securities - available-for-sale, at fair value:			
U.S. Treasury	5,257	5,551	5,634
U.S. government-sponsored entities and agencies	568,231	664,286	580,624
Mortgage-backed securities	1,448,526	1,667,682	1,462,111
States and political subdivisions	797,533	530,193	431,874
Other securities	362,118	328,495	334,095
Total investment securities - available-for-sale	3,181,665	3,196,207	2,814,338
Investment securities - held-to-maturity, at amortized cost (fair value \$524,597; \$727,703; and \$749,363, respectively)	525,718	684,063	695,139
Federal Home Loan Bank/Federal Reserve Bank stock, at cost	136,206	119,686	109,715
Loans held for sale, at fair value	26,198	17,930	27,425
Loans:			
Commercial	2,962,895	2,717,269	2,001,621
Commercial real estate	4,451,772	4,354,552	3,259,998
Residential real estate	2,153,973	2,167,053	2,099,374
Consumer credit, net of unearned income	1,726,989	1,879,247	1,871,047
Total loans	11,295,629	11,118,121	9,232,040
Allowance for loan losses	(53,660)	(50,381)	(50,986)
Net loans	11,241,969	11,067,740	9,181,054
Premises and equipment, net	449,304	458,074	413,933
Accrued interest receivable	81,290	87,102	79,830
Goodwill	828,804	828,051	655,018
Other intangible assets	45,417	53,096	31,876
Company-owned life insurance	405,492	403,753	354,875
Net deferred tax assets	90,187	110,857	146,780
Loan servicing rights	24,303	24,661	25,023
Assets held for sale	10,222	7,180	11,725
Other real estate owned and repossessed personal property	3,729	8,810	11,071
Other assets	153,016	155,066	131,503

Total assets	\$ 17,482,990	\$ 17,518,292	\$ 14,957,281
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Liabilities

Deposits:

Noninterest-bearing demand	\$ 3,600,793	\$ 3,680,807	\$ 3,011,156
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Interest-bearing:

Checking and NOW	3,054,302	3,115,822	2,639,813
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Savings	3,026,110	3,035,622	2,924,689
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Money market	1,090,621	1,139,077	672,391
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Time	1,824,550	1,634,436	1,435,665
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Total deposits	12,596,376	12,605,764	10,683,714
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Federal funds purchased and interbank borrowings	175,044	335,033	227,029
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Securities sold under agreements to repurchase	347,511	384,810	298,094
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Federal Home Loan Bank advances	1,757,308	1,609,579	1,515,628
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Other borrowings	250,241	248,782	219,167
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Accrued expenses and other liabilities	156,295	179,927	127,055
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Total liabilities	15,282,775	15,363,895	13,070,687
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Shareholders Equity

Preferred stock, 2,000 shares authorized, no shares issued or outstanding

Common stock, \$1.00 per share stated value, 300,000 shares authorized, 152,351; 152,040; and 135,516 shares issued and outstanding, respectively	152,351	152,040	135,516
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Capital surplus	1,642,790	1,639,499	1,352,411
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Retained earnings	471,777	413,130	429,787
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Accumulated other comprehensive income (loss), net of tax	(66,703)	(50,272)	(31,120)
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Total shareholders equity	2,200,215	2,154,397	1,886,594
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Total liabilities and shareholders equity	\$ 17,482,990	\$ 17,518,292	\$ 14,957,281
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The accompanying notes to consolidated financial statements are an integral part of these statements.

Table of Contents**OLD NATIONAL BANCORP****CONSOLIDATED STATEMENTS OF INCOME (unaudited)**

(dollars and shares in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Interest Income				
Loans including fees:				
Taxable	\$ 124,610	\$ 92,189	\$ 242,999	\$ 184,390
Nontaxable	3,984	3,236	7,858	6,415
Investment securities:				
Taxable	18,367	15,501	37,171	31,186
Nontaxable	6,658	7,228	13,207	14,600
Money market and other interest-earning investments	117	55	207	86
Total interest income	153,736	118,209	301,442	236,677
Interest Expense				
Deposits	9,139	4,724	16,394	9,107
Federal funds purchased and interbank borrowings	647	422	1,664	778
Securities sold under agreements to repurchase	434	334	793	590
Federal Home Loan Bank advances	8,824	6,017	16,604	11,329
Other borrowings	2,729	2,379	5,452	4,739
Total interest expense	21,773	13,876	40,907	26,543
Net interest income	131,963	104,333	260,535	210,134
Provision for loan losses	2,446	1,355	2,826	1,702
Net interest income after provision for loan losses	129,517	102,978	257,709	208,432
Noninterest Income				
Wealth management fees	9,746	9,679	18,772	18,678
Service charges on deposit accounts	10,765	10,040	21,524	19,883
Debit card and ATM fees	5,080	4,436	9,945	8,672
Mortgage banking revenue	5,189	5,186	9,381	9,412
Investment product fees	5,066	5,004	10,097	9,993
Capital markets income	896	2,747	1,394	3,778
Company-owned life insurance	2,430	2,117	5,035	4,266
Net securities gains (losses)	1,494	3,075	2,282	4,575
Recognition of deferred gain on sale leaseback transactions	394	538	789	1,075
Other income	8,229	6,449	11,975	11,859
Total noninterest income	49,289	49,271	91,194	92,191

Noninterest Expense

Salaries and employee benefits	66,592	57,606	130,771	114,170
Occupancy	12,873	10,539	26,153	22,673
Equipment	3,728	3,350	7,293	6,577
Marketing	3,962	3,673	7,659	6,723
Data processing	9,724	8,226	18,124	15,834
Communication	2,772	2,288	5,836	4,702
Professional fees	2,923	4,077	5,653	6,728
Loan expenses	1,843	1,693	3,587	3,324
Supplies	903	594	1,625	1,173
FDIC assessment	3,161	2,130	5,806	4,617
Other real estate owned expense	196	1,009	545	2,124
Amortization of intangibles	3,416	2,781	7,025	5,801
Amortization of tax credit investments	11,858		12,574	
Other expense	6,509	4,845	14,966	10,256
Total noninterest expense	130,460	102,811	247,617	204,702
Income before income taxes	48,346	49,438	101,286	95,921
Income tax expense	4,345	10,584	9,302	21,075
Net income	\$ 44,001	\$ 38,854	\$ 91,984	\$ 74,846
Net income per common share - basic	\$ 0.29	\$ 0.28	\$ 0.61	\$ 0.55
Net income per common share - diluted	0.29	0.28	0.60	0.55
Weighted average number of common shares outstanding - basic	151,878	135,085	151,800	134,999
Weighted average number of common shares outstanding - diluted	152,568	135,697	152,483	135,641
Dividends per common share	\$ 0.13	\$ 0.13	\$ 0.26	\$ 0.26

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

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OLD NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$ 44,001	\$ 38,854	\$ 91,984	\$ 74,846
Other comprehensive income (loss):				
Change in securities available-for-sale:				
Unrealized holding gains (losses) for the period	(7,327)	30,627	(33,121)	46,407
Reclassification for securities transferred to held-to-maturity			14,007	
Reclassification adjustment for securities gains realized in income	(1,494)	(3,075)	(2,282)	(4,575)
Income tax effect	2,070	(10,017)	5,180	(15,277)
Unrealized gains (losses) on available-for-sale securities	(6,751)	17,535	(16,216)	26,555
Change in securities held-to-maturity:				
Adjustment for securities transferred to available-for-sale			19,412	
Adjustment for securities transferred from available-for-sale			(14,007)	
Amortization of unrealized losses on securities transferred from available-for-sale	521	453	1,112	902
Income tax effect	(119)	(155)	(1,145)	(309)
Changes from securities held-to-maturity	402	298	5,372	593
Cash flow hedges:				
Net unrealized derivative gains (losses) on cash flow hedges	1,516	(2,387)	6,079	(1,807)
Reclassification adjustment for losses realized in net income	10	1,734	779	3,533
Income tax effect	(375)	248	(1,683)	(656)
Changes from cash flow hedges	1,151	(405)	5,175	1,070
Defined benefit pension plans:				
Amortization of net loss recognized in income	27	27	54	54
Income tax effect	(6)	(10)	(13)	(20)
Changes from defined benefit pension plans	21	17	41	34
Other comprehensive income (loss), net of tax	(5,177)	17,445	(5,628)	28,252
Comprehensive income	\$ 38,824	\$ 56,299	\$ 86,356	\$ 103,098

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

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OLD NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (unaudited)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
(dollars in thousands)					
Balance at December 31, 2016	\$ 135,159	\$ 1,348,338	\$ 390,292	\$ (59,372)	\$ 1,814,417
Net income			74,846		74,846
Other comprehensive income (loss)				28,252	28,252
Dividends - common stock (\$0.26 per share)			(35,219)		(35,219)
Common stock issued	11	177			188
Common stock repurchased	(104)	(1,748)			(1,852)
Share-based compensation expense		3,184			3,184
Stock activity under incentive compensation plans	450	2,460	(132)		2,778
Balance at June 30, 2017	\$ 135,516	\$ 1,352,411	\$ 429,787	\$ (31,120)	\$ 1,886,594
Balance at December 31, 2017	\$ 152,040	\$ 1,639,499	\$ 413,130	\$ (50,272)	\$ 2,154,397
Cumulative effect of change in accounting principles (Note 3)			(4,127)	(52)	(4,179)
Reclassification of certain tax effects related to the Tax Cuts and Jobs Act of 2017 (Note 3)			10,751	(10,751)	
Net income			91,984		91,984
Other comprehensive income (loss)				(5,628)	(5,628)
Dividends - common stock (\$0.26 per share)			(39,588)		(39,588)
Common stock issued	14	208			222
Common stock repurchased	(100)	(1,649)			(1,749)
Share-based compensation expense		3,606			3,606
Stock activity under incentive compensation plans	397	1,126	(373)		1,150
Balance at June 30, 2018	\$ 152,351	\$ 1,642,790	\$ 471,777	\$ (66,703)	\$ 2,200,215

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

Table of Contents**OLD NATIONAL BANCORP****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

(dollars in thousands)	Six Months Ended	
	2018	2017
Cash Flows From Operating Activities		
Net income	\$ 91,984	\$ 74,846
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	11,772	10,406
Amortization of other intangible assets	7,025	5,801
Amortization of tax credit investments	12,574	
Net premium amortization on investment securities	7,538	7,529
Accretion income related to acquired loans	(22,312)	(22,157)
Share-based compensation expense	3,606	3,184
Excess tax (benefit) expense on share-based compensation	432	160
Provision for loan losses	2,826	1,702
Net securities (gains) losses	(2,282)	(4,575)
Recognition of deferred gain on sale leaseback transactions	(789)	(1,075)
Net (gains) losses on sales of loans and other assets	1,078	(5,398)
Increase in cash surrender value of company-owned life insurance	(5,035)	(4,266)
Residential real estate loans originated for sale	(240,201)	(179,025)
Proceeds from sales of residential real estate loans	234,736	246,549
(Increase) decrease in interest receivable	2,316	1,551
(Increase) decrease in other real estate owned	5,081	7,475
(Increase) decrease in other assets	16,127	3,707
Increase (decrease) in accrued expenses and other liabilities	(21,669)	(20,504)
Total adjustments	12,823	51,064
Net cash flows provided by (used in) operating activities	104,807	125,910
Cash Flows From Investing Activities		
Purchases of investment securities available-for-sale	(235,161)	(414,742)
Purchases of Federal Home Loan Bank/Federal Reserve Bank stock	(16,520)	(8,008)
Proceeds from maturities, prepayments, and calls of investment securities available-for-sale	220,753	252,486
Proceeds from sales of investment securities available-for-sale	131,321	186,277
Proceeds from maturities, prepayments, and calls of investment securities held-to-maturity	35,750	48,204
Proceeds from sales of Federal Home Loan Bank/Federal Reserve Bank stock		9
Proceeds from sales of trading securities	128	127
Proceeds from sale of student loan portfolio	70,674	

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Net principal collected from (loans made to) loan customers	(219,685)	(199,895)
Proceeds from settlements on company-owned life insurance	3,296	2,347
Proceeds from sales of premises and equipment and other assets	4,708	10,120
Purchases of premises and equipment and other assets	(17,005)	(9,461)
Net cash flows provided by (used in) investing activities	(21,741)	(132,536)

Cash Flows From Financing Activities

Net increase (decrease) in:		
Deposits	(9,527)	(59,539)
Federal funds purchased and interbank borrowings	(159,989)	14,026
Securities sold under agreements to repurchase	(37,299)	(68,958)
Other borrowings	1,159	(97)
Payments for maturities of Federal Home Loan Bank advances	(898,801)	(892,298)
Proceeds from Federal Home Loan Bank advances	1,045,000	1,055,000
Cash dividends paid on common stock	(39,588)	(35,219)
Common stock repurchased	(1,749)	(1,852)
Proceeds from exercise of stock options	948	2,597
Common stock issued	222	188
Net cash flows provided by (used in) financing activities	(99,624)	13,848
Net increase (decrease) in cash and cash equivalents	(16,558)	7,222
Cash and cash equivalents at beginning of period	290,432	255,519

Cash and cash equivalents at end of period	\$ 273,874	\$ 262,741
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Supplemental cash flow information:

Total interest paid	\$ 40,426	\$ 26,534
Total taxes paid (net of refunds)	\$ (819)	\$ 3,000
Securities transferred from held-to-maturity to available-for-sale	\$ 447,026	\$
Securities transferred from available-for-sale to held-to-maturity	\$ 323,990	\$

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

Table of Contents**OLD NATIONAL BANCORP****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)****NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements include the accounts of Old National Bancorp and its wholly-owned affiliates (hereinafter collectively referred to as Old National) and have been prepared in conformity with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. Such principles require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and the disclosures of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, the consolidated financial statements contain all the normal and recurring adjustments necessary for a fair statement of the financial position of Old National as of June 30, 2018 and 2017, and December 31, 2017, and the results of its operations for the three and six months ended June 30, 2018 and 2017. Interim results do not necessarily represent annual results. These financial statements should be read in conjunction with Old National's Annual Report for the year ended December 31, 2017.

All significant intercompany transactions and balances have been eliminated. Certain prior year amounts have been reclassified to conform to the 2018 presentation. Such reclassifications had no effect on net income or shareholders equity and were insignificant amounts.

NOTE 2 REVENUE RECOGNITION

In May 2014, the FASB issued an update (ASU No. 2014-09, *Revenue from Contracts with Customers*) creating FASB Topic 606, *Revenue from Contracts with Customers*. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The scope of this update explicitly excludes net interest income, as well as other revenues from transactions involving financial instruments, such as loans and securities. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017 and did not have a material impact on the consolidated financial statements. Old National finalized the in-depth assessment and identified the revenue line items within the scope of this new guidance. For Old National, the revenue streams that are affected by this update are presented within noninterest income.

In March 2016, the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*. The amendments relate to when another party, along with the entity, is involved in providing a good or service to a customer. Topic 606 requires an entity to determine whether the nature of its promise is to provide that good or service to the customer (that is, the entity is a principal) or to arrange for the good or service to be provided to the customer by the other party (that is, the entity is an agent). This determination is based upon whether the entity controls the good or the service before it is transferred to the customer. Topic 606 includes indicators to assist in this evaluation. The amendments in this update affect the guidance in ASU No. 2014-09 above. The effective date is the same as the effective date of ASU No. 2014-09.

In April 2016, the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. The amendments clarify the following two aspects of Topic 606: identifying performance obligations, and the licensing implementation guidance. Before an entity can identify its performance obligations in a contract with a customer, the entity first identifies the promised goods or services in the contract. The amendments in this update are expected to reduce the cost and complexity of applying the guidance on identifying promised goods or services. To identify performance obligations in a contract, an entity evaluates whether promised goods and services are distinct. Topic 606 includes two criteria for assessing whether promises to transfer goods or services are distinct. One of those criteria is that the promises are separately

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identifiable. This update will improve the guidance on assessing that criterion. Topic 606 also includes implementation guidance on determining whether an entity's promise to grant a license provides a customer with either a right to use the entity's intellectual property, which is satisfied at a point in time, or a right to access the entity's intellectual property, which is satisfied over time. The amendments in this update are intended to improve the operability and understandability of the licensing implementation guidance. The amendments in this update affect the guidance in ASU No. 2014-09 above. The effective date is the same as the effective date of ASU No. 2014-09.

In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*. The amendments do not change the core revenue recognition principle in Topic 606. The amendments provide clarifying guidance in certain narrow areas and add some practical expedients.

In December 2016, the FASB issued ASU No. 2016-20, *Revenue from Contracts with Customers (Topic 606): Technical Corrections and Improvements*. The FASB decided to issue a separate update for technical corrections and improvements to Topic 606 and other Topics amended by ASU No. 2014-09 to increase awareness of the proposals and to expedite improvements to ASU No. 2014-09. The amendment affects narrow aspects of the guidance issued in ASU No. 2014-09.

On January 1, 2018, Old National adopted ASU 2014-09, *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, Topic 606) utilizing the modified retrospective application. A significant majority of Old National's revenues are not subject to the new guidance. Services within the scope of Topic 606 include wealth management fees, service charges on deposit accounts, debit card and ATM fees, and investment product fees. Old National enters into various contracts with customers to provide these traditional banking services on a routine basis. Old National's performance obligations are generally service-related and provided on a daily, monthly, or quarterly basis. The performance obligations are generally satisfied as services are rendered and the fees are collected at such time, or shortly thereafter. It is not typical for contracts to require significant judgment to determine the transaction price. The implementation of this update did not have a material impact on the measurement, timing, or recognition of revenue. Accordingly, no cumulative effect adjustment to opening retained earnings was deemed necessary. Results for reporting periods beginning after adoption are presented under Topic 606. As allowed under the update, results for prior periods continue to be reported under the accounting standards in effect for those periods.

Wealth management fees: Old National earns wealth management fees based upon asset custody and investment management services provided to individual and institutional customers. Most of these customers receive monthly or quarterly billings for services rendered based upon the market value of assets in custody. Fees that are transaction based are recognized at the point in time that the transaction is executed.

Service charges on deposit accounts: Old National earns fees from deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees and overdraft fees are recognized at a point in time, since the customer generally has a right to cancel the depository arrangement at any time. The arrangement is considered a day-to-day contract with ongoing renewals and optional purchases, so the duration of the contract does not extend beyond the services already performed. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which Old National satisfies its performance obligation.

Debit card and ATM fees: Debit card and ATM fees include ATM usage fees and debit card interchange income. As with the transaction-based fees on deposit accounts, the ATM fees are recognized at the point in time that Old National fulfills the customer's request. Old National earns interchange fees from cardholder transactions processed

through card association networks. Interchange rates are generally set by the card associations based upon purchase volumes and other factors. Interchange fees represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Investment product fees: Investment product fees are the commissions and fees received from a registered broker/dealer and investment adviser that provide those services to Old National customers. Old National acts as an agent in arranging the relationship between the customer and the third-party service provider. These fees are recognized monthly from the third-party broker based upon services already performed, net of the processing fees charged to Old National by the broker.

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The consolidated statements of income include all categories of noninterest income. The following table reflects only the categories of noninterest income that are within the scope of Topic 606:

(dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Wealth management fees	\$ 9,746	\$ 9,679	\$ 18,772	\$ 18,678
Service charges on deposit accounts	10,765	10,040	21,524	19,883
Debit card and ATM fees	5,080	4,436	9,945	8,672
Investment product fees	5,066	5,004	10,097	9,993
Other income:				
Merchant processing fees	778	633	1,419	1,230
Gain (loss) on other real estate owned	586	(41)	721	617
Safe deposit box fees	224	207	628	514
Insurance premiums and commissions	78	160	182	267
Total	\$ 32,323	\$ 30,118	\$ 63,288	\$ 59,854

The adoption of Topic 606 did not have a material impact on our consolidated financial position, results of operations, equity, or cash flows as of the adoption date or for the three or six months ended June 30, 2018.

NOTE 3 RECENT ACCOUNTING PRONOUNCEMENTS

FASB ASC 825 In January 2016, the FASB issued an update (ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*). The amendments in this update impact public business entities as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; and when a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (4) require entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (5) require an entity to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (6) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (7) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017 and did not have a material impact on the consolidated financial statements.

FASB ASC 842 In February 2016, the FASB issued its new lease accounting guidance in ASU No. 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2018. Old National has formed a cross functional team to plan and execute the adoption of this standard. The implementation efforts are ongoing, including the review of our leases and related accounting policies, review of contracts for embedded leases, and the implementation of a new lease software solution. Based on leases outstanding at June 30, 2018, Old

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National does not expect the new standard to have a material impact on the income statement, but anticipates a \$125 million to \$140 million increase in assets and liabilities. Decisions to repurchase, modify, or renew leases prior to the implementation date will impact this level of materiality.

In July 2018, the FASB issued an update (ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*). The FASB decided to issue a separate update for the improvements related to ASU No. 2016-02 to increase stakeholders awareness of the amendments and to expedite the improvements. The amendments affect narrow aspects of the guidance issued in ASU No. 2016-02.

FASB ASC 815 In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The amendments in the update make certain targeted improvements to simplify the application of the hedge accounting guidance in GAAP. The amendments in this update better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. This update addresses several limitations that GAAP placed on the risk components, how an entity can designate the hedged item in a fair value hedge of interest rate risk, and how an entity can measure changes in fair value of the hedged item attributable to interest rate risk. In addition to the amendments to the designation and measurement guidance for qualifying hedging relationships, the amendments in this update also align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements to increase the understandability of the results of an entity's intended hedging strategies. The amendments in this update require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. Prior to the issuance of this update, GAAP provided special hedge accounting only for the portion of the hedge deemed to be highly effective and required an entity to separately reflect the amount by which the hedging instrument did not offset the hedged item, which is referred to as the ineffective amount. However, the concept and reporting of hedge ineffectiveness were difficult for financial statement users to understand and, at times, for preparers to explain. The FASB decided on an approach that no longer separately measures and reports hedge ineffectiveness. This update also includes certain targeted improvements to ease the application of current guidance related to the assessment of hedge effectiveness. Prior to the issuance of this update, GAAP contained specific requirements for initial and ongoing quantitative hedge effectiveness testing and strict requirements for specialized effectiveness testing methods that allowed an entity to forgo quantitative hedge effectiveness assessments for qualifying relationships. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2018. Early adoption is permitted in any interim period. Management elected to early adopt this update effective January 1, 2018 using the modified retrospective method. The impact of the adoption resulted in a reduction to Old National's opening retained earnings of \$3.2 million. In addition, as permitted by the amendments in the update, Old National reclassified \$447.0 million in state and political subdivision securities with unrealized holding gains of \$26.1 million from the held-to-maturity portfolio to the available-for-sale portfolio.

FASB ASC 718 In May 2017, the FASB issued ASU No. 2017-09, *Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting*. The amendments in this update provide guidance about which changes to the terms and conditions of a share-based payment award require an entity to apply modification accounting. An entity should account for the effect of a modification unless all the following are met: (1) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified if the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award

is modified; (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017 and did not have a material impact on the consolidated financial statements.

FASB ASC 326 In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (CECL)*. The main objective of this amendment is to provide financial statement users with more decision-useful information about the expected credit losses on

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financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendment requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to enhance their credit loss estimates. The amendment requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2019. Early adoption will be permitted beginning after December 15, 2018.

As previously disclosed, Old National formed a cross functional committee to oversee the adoption of the ASU at the effective date. A working group was also formed and has developed a project plan focused on understanding the ASU, researching issues, identifying data needs for modeling inputs, technology requirements, modeling considerations, and ensuring overarching governance has been achieved for each objective and milestone. The project plan is targeting data and model validation completion in early 2019, with parallel processing of our existing allowance for loan losses model with the CECL for 2-4 quarters prior to implementation, depending on how model completion and validation occurs over the remainder of 2018. Currently, the working group has identified seven distinct loan portfolios for which a model has been or is in the process of being developed. For two of the loan portfolios, the data sets have been identified, populated, and internally validated. Additionally, models have been built, tested, and internally validated. During the remainder of 2018, Old National is focused on the completion of its remaining models, refining assumptions, and continued review and challenge of its models. Concurrent with this, Old National is also focused on researching and resolving interpretive accounting issues in the ASU, contemplating various related accounting policies, developing processes and related controls, and considering various reporting disclosures.

As of the beginning of the first reporting period in which the new standard is effective, Old National expects to recognize a one-time cumulative effect adjustment increasing the allowance for loan losses, since the ASU covers credit losses over the expected life of a loan as well as considering future changes in macroeconomic conditions. The magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements cannot yet be reasonably estimated.

FASB ASC 740 In October 2016, the FASB issued ASU No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. Current guidance prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. This prohibition on recognition is an exception to the principle of comprehensive recognition of current and deferred income taxes in generally accepted accounting principles. The exception has led to diversity in practice and is a source of complexity in financial reporting. FASB decided that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this update eliminate the exception for an intra-entity transfer of an asset other than inventory. The amendments in this update do not include new disclosure requirements; however, existing disclosure requirements might be applicable when accounting for the current and deferred income taxes for an intra-entity transfer of an asset other than inventory. The amendments in this update became effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. The amendments in this update were applied on a modified retrospective basis through a cumulative-effect reduction of \$1.0 million directly to retained earnings as of the beginning of 2018.

FASB ASC 805 In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. The amendments in this update provide a more robust framework to use in

determining when a set of assets and activities is a business. Because the current definition of a business is interpreted broadly and can be difficult to apply, stakeholders indicated that analyzing transactions is inefficient and costly and that the definition does not permit the use of reasonable judgment. The amendments provide more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. Old National has completed its evaluation of adopting the new guidance on the consolidated financial statements and there is no impact to record.

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FASB ASC 350 In January 2017, the FASB issued ASU No. 2017-04, *Intangibles: Goodwill and Other: Simplifying the Test for Goodwill Impairment*. To simplify the subsequent measurement of goodwill, the amendments eliminate Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, the income tax effects of tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the qualitative impairment test is necessary. The amendments should be applied on a prospective basis. The nature of and reason for the change in accounting principle should be disclosed upon transition. The amendments in this update should be adopted for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted on testing dates after January 1, 2017. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but it is not expected to have a material impact.

FASB ASC 610 In February 2017, the FASB issued ASU No. 2017-05, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Topic 610): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*. Subtopic 610-20 was originally issued as part of ASU No. 2014-09 to provide guidance for recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. This update was issued to help clarify uncertainties and complexities of ASU 2014-09. The amendments in this update define the term in substance nonfinancial asset, in part, as a financial asset promised to a counterparty in a contract if substantially all of its fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets. If substantially all of the fair value of the assets that are promised to the counterparty in a contract is concentrated in nonfinancial assets, then all of the financial assets promised to the counterparty are in substance nonfinancial assets. The amendments in this update also clarify that nonfinancial assets within the scope of Subtopic 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. The amendments in this update require an entity to derecognize a distinct nonfinancial asset or distinct in substance nonfinancial asset in a partial sale transaction when it (1) does not have (or ceases to have) a controlling financial interest in the legal entity that holds the asset in accordance with Topic 810 and (2) transfers control of the asset in accordance with Topic 606. Once an entity transfers control of a distinct nonfinancial asset or distinct in substance nonfinancial asset, it is required to measure any noncontrolling interest it receives (or retains) at fair value. The amendments were effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period and did not have a material impact on the consolidated financial statements.

FASB ASC 715 In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The amendments in this update require that an employer disaggregate the service cost component from the other components of net benefit cost. The amendments also provide explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. The amendments in this update improve the consistency, transparency, and usefulness of financial information to users that have communicated that the service cost component generally is analyzed differently from the other components of net benefit cost. The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017 and did not have a material impact on the consolidated financial statements.

FASB ASC 310 In March 2017, the FASB issued ASU No. 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. This update amends the amortization period for certain purchased callable debt securities held at a premium. FASB is shortening the amortization period for the premium to the earliest call date. Under current GAAP, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. Concerns were raised that current GAAP excludes certain callable debt securities from consideration of early repayment of principal even if the holder is certain that the call will be exercised. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. There is diversity in practice (1) in the amortization period for premiums of callable debt securities and (2) in how the potential for exercise of a call is factored into current impairment assessments. The amendments in this update become effective for annual periods

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and interim periods within those annual periods beginning after December 15, 2018. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but it is not expected to have a material impact.

FASB ASC 220 In February 2018, the FASB issued ASU No. 2018-02, *Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in this ASU help organizations address certain stranded income tax effects in AOCI resulting from the Tax Cuts and Jobs Act. The ASU provides financial statement preparers with an option to reclassify stranded tax effects within AOCI to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Management has elected to early adopt this update effective January 1, 2018, which resulted in a reclassification that decreased beginning accumulated other comprehensive income and increased beginning retained earnings by \$10.8 million.

FASB ASC 825 In February 2018, the FASB issued an update (ASU No. 2018-03, *Technical Corrections and Improvements to Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*). The amendments in this update clarified the guidance in ASU No. 2016-01 specifically for equity securities without a readily determinable fair value and financial liabilities for which the fair value option is elected. The amendments in this update become effective for annual periods beginning after December 15, 2017 and interim periods within those fiscal years beginning after June 15, 2018. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

FASB ASC 718 In June 2018, the FASB issued ASU No. 2018-07, *Compensation Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. The amendments in this update expand the scope of Topic 718, Compensation Stock Compensation (which currently only includes share-based payments to employees) to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. The ASU supersedes Subtopic 505-50, Equity Equity-Based Payments to Non-Employees. The amendments in this update become effective for annual periods beginning after December 15, 2018, including interim periods within that fiscal year and will not have a material impact on the consolidated financial statements.

FASB ASC 958 In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this update clarify and improve the scope and accounting guidance around contributions of cash and other assets received and made by not-for-profit organizations and business enterprises. The ASU clarifies and improves current guidance about whether a transfer of assets, or the reduction, settlement, or cancellation of liabilities, is a contribution or an exchange transaction. It provides criteria for determining whether the resource provider is receiving commensurate value in return for the resources transferred which, depending on the outcome, determines whether the organization follows contribution guidance or exchange transaction guidance in the revenue recognition and other applicable standards. It also provides a more robust framework for determining whether a contribution is conditional or unconditional, and for distinguishing a donor-imposed condition from a donor-imposed restriction. This is important because such classification affects the timing of contribution revenue and expense recognition. The new ASU does not apply to transfers of assets from governments to businesses. The amendments in this update become effective for a public business entity for transactions in which the entity serves as a resource recipient to annual periods beginning after June 15, 2018, including interim periods within those annual periods. The amendments in this update become effective for a public business entity for a public business for transactions in which the entity serves as a resource provider to annual periods beginning after December 15, 2018, including interim periods within those annual periods.

Early adoption is permitted. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

In July 2018, the FASB issued an update (ASU No. 2018-09, *Codification Improvements*). The amendments in this update affect a wide variety of topics in the Codification and are intended to clarify the Codification or correct the unintended application of guidance that is not expected to have a significant effect on current accounting practice. The transition and effective date guidance is based on the facts and circumstances of each amendment. Old National is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but it is not expected to have a material impact.

Table of Contents**NOTE 4 ACQUISITION AND DIVESTITURE ACTIVITY****Acquisitions***Anchor Bancorp, Inc.*

Effective November 1, 2017, Old National completed the acquisition of St. Paul, Minnesota-based Anchor (MN) through a stock and cash merger. Anchor (MN) was a bank holding company with Anchor Bank (MN) as its wholly-owned subsidiary. Founded in 1967 and with 17 total branches, Anchor Bank (MN) was one of the largest community banks headquartered in the Twin Cities, and also served Mankato, Minnesota. Anchor Bank (MN) has no affiliation with the former AnchorBank (WI) in Madison, Wisconsin, which Old National acquired in 2016. Old National believes that it will be able to achieve cost savings by integrating the two companies and combining accounting, data processing, retail and lending support, and other administrative functions, which will enable Old National to achieve economies of scale in these areas.

Pursuant to the merger agreement, each holder of Anchor (MN) common stock received \$2.625 in cash and 1.350 shares of Old National Common Stock per share of Anchor (MN) common stock such holder owned. The total fair value of consideration for Anchor (MN) was \$332.8 million, consisting of \$31.9 million of cash and the issuance of 16.5 million shares of Old National Common Stock valued at \$300.8 million. This acquisition was accounted for under the acquisition method of accounting. Accordingly, Old National recognized amounts for identifiable assets acquired and liabilities assumed at their estimated acquisition date fair values. Through June 30, 2018, transaction and integration costs of \$17.0 million associated with this acquisition have been expensed and remaining integration costs will be expensed in future periods as incurred.

During the six months ended June 30, 2018, immaterial adjustments were made to the preliminary valuation of the assets acquired and liabilities assumed. These adjustments affected goodwill, definite lived intangible assets, premises and equipment, other assets, and deposits. As of June 30, 2018, Old National finalized its valuation of all assets acquired and liabilities assumed, resulting in no material change to acquisition accounting adjustments. A summary of the fair values of the acquired assets, liabilities assumed, and resulting goodwill follows (in thousands):

Cash and cash equivalents	\$ 34,501
Investment securities	302,195
FHLB/Federal Reserve Bank stock	6,585
Loans held for sale	1,407
Loans	1,593,991
Premises and equipment	33,433
Accrued interest receivable	5,872
Other real estate owned	1,058
Company-owned life insurance	44,490
Other assets	30,036
Deposits	(1,777,588)
Federal funds purchased and interbank borrowings	(45,600)
Securities sold under agreements to repurchase	(22,965)
Other borrowings	(49,257)
Accrued expenses and other liabilities	(25,784)

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Net tangible assets acquired	132,374
Definite-lived intangible assets acquired	26,606
Goodwill	173,785
Total consideration	\$ 332,765

Goodwill related to this acquisition will not be deductible for tax purposes.

The estimated fair value of the core deposit intangible was \$26.6 million and is being amortized over an estimated useful life of 10 years.

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Acquired loan data for Anchor (MN) can be found in the table below:

(in thousands)	Fair Value of Acquired Loans at Acquisition Date	Gross Contractual Cash Flows at Acquisition Date	Best Estimate at Acquisition Date of Contractual Cash Flows Not Expected to be Collected
Acquired receivables subject to ASC 310-30	\$ 10,555	\$ 16,898	\$ 4,787
Acquired receivables not subject to ASC 310-30	\$ 1,583,436	\$ 1,879,449	\$ 87,767

Divestitures

Based on an ongoing assessment of our service and delivery network, Old National consolidated 29 branches during 2017 and 9 branches during the six months ended June 30, 2018. In addition, there is one branch scheduled to be consolidated in the third quarter of this year.

Old National has entered into a branch purchase and assumption agreement for the sale of ten Old National branches in Wisconsin to Marine Credit Union of La Crosse, Wisconsin. Assets associated with this divestiture are included in assets held for sale on the balance sheet. The branch sale includes the assumption of approximately \$261 million in deposits and no loans. Subject to regulatory approval and other terms and conditions, the sale is expected to close in the fourth quarter of 2018.

Pending Acquisition

On June 20, 2018, Old National entered into an agreement to acquire Minnesota-based Klein through a 100% stock merger. Klein is a bank holding company with KleinBank as its wholly-owned subsidiary. Founded in 1907 and headquartered in Chaska, Minnesota with 18 full-service branches, KleinBank is the largest family-owned community bank serving the Twin Cities and its western communities. At March 31, 2018, Klein had total assets of \$2.0 billion and \$1.7 billion of deposit liabilities. Pursuant to the merger agreement, each holder of Klein common stock will receive 7.92 shares of Old National common stock per share of Klein common stock such holder owns. Based on Old National's June 20, 2018 closing price of \$19.05 per share, this represents a total transaction value of approximately \$433.8 million. The transaction value is likely to change until closing due to fluctuations in the price of Old National common stock and is also subject to adjustment under certain circumstances as provided in the merger agreement. The transaction remains subject to regulatory approval and the vote of Klein shareholders. The transaction is anticipated to close in the fourth quarter of 2018.

NOTE 5 NET INCOME PER SHARE

Basic and diluted net income per share are calculated using the two-class method. Net income is divided by the weighted-average number of common shares outstanding during the period. Adjustments to the weighted average number of common shares outstanding are made only when such adjustments will dilute net income per common share. Net income is then divided by the weighted-average number of common shares and common share equivalents during the period.

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The following table reconciles basic and diluted net income per share for the three and six months ended June 30, 2018 and 2017:

(dollars and shares in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic Earnings Per Share				
Net income	\$ 44,001	\$ 38,854	\$ 91,984	\$ 74,846
Weighted average common shares outstanding	151,878	135,085	151,800	134,999
Basic Net Income Per Share	\$ 0.29	\$ 0.28	\$ 0.61	\$ 0.55
Diluted Earnings Per Share				
Net income	\$ 44,001	\$ 38,854	\$ 91,984	\$ 74,846
Weighted average common shares outstanding	151,878	135,085	151,800	134,999
Effect of dilutive securities:				
Restricted stock	623	523	610	543
Stock options (1)	67	89	73	99
Weighted average shares outstanding	152,568	135,697	152,483	135,641
Diluted Net Income Per Share	\$ 0.29	\$ 0.28	\$ 0.60	\$ 0.55

- (1) Options to purchase 14 thousand shares and 55 thousand shares outstanding at June 30, 2018 and 2017, respectively, were not included in the computation of net income per diluted share for the three and six months ended June 30, 2018 and 2017 because the exercise price of these options was greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

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The following table summarizes the amortized cost and fair value of the available-for-sale and held-to-maturity investment securities portfolio at June 30, 2018 and December 31, 2017 and the corresponding amounts of unrealized gains and losses therein:

(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2018				
Available-for-Sale				
U.S. Treasury	\$ 5,312	\$	\$ (55)	\$ 5,257
U.S. government-sponsored entities and agencies	583,644		(15,413)	568,231
Mortgage-backed securities - Agency	1,503,636	501	(55,611)	1,448,526
States and political subdivisions	793,141	8,406	(4,014)	797,533
Pooled trust preferred securities	13,887		(5,682)	8,205
Other securities	359,820	345	(6,252)	353,913
Total available-for-sale securities	\$ 3,259,440	\$ 9,252	\$ (87,027)	\$ 3,181,665
Held-to-Maturity				
U.S. government-sponsored entities and agencies	\$ 73,570	\$	\$ (2,286)	\$ 71,284
Mortgage-backed securities - Agency	139,594	58	(3,868)	135,784
States and political subdivisions	312,554	7,209	(2,234)	317,529
Total held-to-maturity securities	\$ 525,718	\$ 7,267	\$ (8,388)	\$ 524,597
December 31, 2017				
Available-for-Sale				
U.S. Treasury	\$ 5,473	\$ 83	\$ (5)	\$ 5,551
U.S. government-sponsored entities and agencies	675,643	3	(11,360)	664,286
Mortgage-backed securities - Agency	1,704,014	1,600	(37,932)	1,667,682
States and political subdivisions	529,835	5,085	(4,727)	530,193
Pooled trust preferred securities	16,605		(8,157)	8,448
Other securities	321,016	1,172	(2,141)	320,047
Total available-for-sale securities	\$ 3,252,586	\$ 7,943	\$ (64,322)	\$ 3,196,207
Held-to-Maturity				
Mortgage-backed securities - Agency	\$ 6,903	\$ 153	\$	\$ 7,056
States and political subdivisions	677,160	43,495	(8)	720,647
Total held-to-maturity securities	\$ 684,063	\$ 43,648	\$ (8)	\$ 727,703

As previously disclosed in Note 3, upon the early adoption of ASU No. 2017-12 on January 1, 2018, Old National reclassified \$447.0 million in state and political subdivision securities from the held-to-maturity portfolio to the available-for-sale portfolio. Separately, on January 1, 2018, U.S. government-sponsored entities and agencies, agency

mortgage-backed securities, and state and political subdivision securities with a fair value of \$324.0 million were transferred from the available-for-sale portfolio to the held-to-maturity portfolio. The \$10.8 million unrealized holding loss, net of tax, at the date of transfer shall continue to be reported as a separate component of shareholders' equity and will be amortized over the remaining life of the securities as an adjustment to yield. The corresponding discount on these securities will offset this adjustment to yield as it is amortized.

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Proceeds from sales or calls of available-for-sale investment securities, the resulting realized gains and realized losses, and other securities gains or losses were as follows for the three and six months ended June 30, 2018 and 2017:

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Proceeds from sales of available-for-sale securities	\$ 47,064	\$ 152,689	\$ 131,321	\$ 186,277
Proceeds from calls of available-for-sale securities	11,211	60,600	28,647	71,120
Total	\$ 58,275	\$ 213,289	\$ 159,968	\$ 257,397
Realized gains on sales of available-for-sale securities	\$ 1,251	\$ 2,954	\$ 3,259	\$ 4,283
Realized gains on calls of available-for-sale securities	283		284	
Realized losses on sales of available-for-sale securities	(48)	(13)	(1,305)	(43)
Realized losses on calls of available-for-sale securities	(4)	(7)	(53)	(8)
Other securities gains (losses) (1)	12	141	97	343
Net securities gains (losses)	\$ 1,494	\$ 3,075	\$ 2,282	\$ 4,575

(1) Other securities gains (losses) includes net realized and unrealized gains or losses associated with trading securities and mutual funds.

Trading securities, which consist of mutual funds held in trusts associated with deferred compensation plans for former directors and executives, are recorded at fair value and totaled \$5.6 million at June 30, 2018 and December 31, 2017.

All the mortgage-backed securities in the investment portfolio are residential mortgage-backed securities. The amortized cost and fair value of the investment securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Weighted average yield is based on amortized cost.

(dollars in thousands)	At June 30, 2018		
	Amortized Cost	Fair Value	Weighted Average Yield
Maturity			
Available-for-Sale			
Within one year	\$ 60,410	\$ 60,376	2.22%
One to five years	511,930	505,586	2.29
Five to ten years	383,847	380,192	3.03

Beyond ten years	2,303,253	2,235,511	2.64
Total	\$ 3,259,440	\$ 3,181,665	2.62%
Held-to-Maturity			
Within one year	\$ 27,128	\$ 27,341	3.75%
One to five years	33,736	34,432	4.06
Five to ten years	75,966	77,962	4.38
Beyond ten years	388,888	384,862	3.59
Total	\$ 525,718	\$ 524,597	3.74%

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The following table summarizes the available-for-sale investment securities with unrealized losses at June 30, 2018 and December 31, 2017 by aggregated major security type and length of time in a continuous unrealized loss position:

(dollars in thousands)	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2018						
Available-for-Sale						
U.S. Treasury	\$ 5,257	\$ (55)	\$	\$	\$ 5,257	\$ (55)
U.S. government-sponsored entities and agencies	178,133	(3,476)	390,097	(11,937)	568,230	(15,413)
Mortgage-backed securities - Agency	728,486	(20,942)	657,333	(34,669)	1,385,819	(55,611)
States and political subdivisions	278,063	(3,761)	8,239	(253)	286,302	(4,014)
Pooled trust preferred securities			8,205	(5,682)	8,205	(5,682)
Other securities	186,479	(3,599)	110,953	(2,653)	297,432	(6,252)
Total available-for-sale	\$ 1,376,418	\$ (31,833)	\$ 1,174,827	\$ (55,194)	\$ 2,551,245	\$ (87,027)

December 31, 2017

Available-for-Sale						
U.S. Treasury	\$ 1,480	\$ (5)	\$	\$	\$ 1,480	\$ (5)
U.S. government-sponsored entities and agencies	201,773	(1,333)	408,493	(10,027)	610,266	(11,360)
Mortgage-backed securities - Agency	789,804	(8,692)	774,825	(29,240)	1,564,629	(37,932)
States and political subdivisions	196,024	(1,899)	90,637	(2,828)	286,661	(4,727)
Pooled trust preferred securities			8,448	(8,157)	8,448	(8,157)
Other securities	61,260	(429)	125,517	(1,712)	186,777	(2,141)
Total available-for-sale	\$ 1,250,341	\$ (12,358)	\$ 1,407,920	\$ (51,964)	\$ 2,658,261	\$ (64,322)

The following table summarizes the held-to-maturity investment securities with unrecognized losses at June 30, 2018 and December 31, 2017 by aggregated major security type and length of time in a continuous unrecognized loss position:

(dollars in thousands)	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
June 30, 2018						
Held-to-Maturity						
U.S. government-sponsored entities and agencies	\$	\$	\$ 71,284	\$ (5,716)	\$ 71,284	\$ (5,716)
Mortgage-backed securities - Agency	35,489	(992)	99,239	(9,029)	134,728	(10,021)

States and political subdivisions	36,231	(1,466)	70,130	(3,692)	106,361	(5,158)
Total held-to-maturity	\$ 71,720	\$ (2,458)	\$ 240,653	\$ (18,437)	\$ 312,373	\$ (20,895)

December 31, 2017**Held-to-Maturity**

States and political subdivisions	\$ 2,309	\$ (8)	\$	\$	\$ 2,309	\$ (8)
Total held-to-maturity	\$ 2,309	\$ (8)	\$	\$	\$ 2,309	\$ (8)

The unrecognized losses on held-to-maturity investment securities presented in the table above include unrecognized losses on securities that were transferred from available-for-sale to held-to-maturity totaling \$12.5 million at June 30, 2018. There were no unrecognized losses on securities that were transferred from available-for-sale to held-to-maturity at December 31, 2017.

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Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities classified as available-for-sale or held-to-maturity are generally evaluated for OTTI under FASB ASC 320, Investments – Debt and Equity Securities. In determining OTTI under FASB ASC 320, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. Otherwise, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors shall be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings shall become the new amortized cost basis of the investment.

There was no OTTI recorded during the six months ended June 30, 2018 or 2017.

At June 30, 2018, Old National's securities portfolio consisted of 1,628 securities, 844 of which were in an unrealized loss position. The unrealized losses attributable to our U.S. Treasury, U.S. government-sponsored entities and agencies, agency mortgage-backed securities, states and political subdivisions, and other securities are the result of fluctuations in interest rates. Our pooled trust preferred securities are discussed below. At June 30, 2018, we had no intent to sell any securities that were in an unrealized loss position nor is it expected that we would be required to sell any securities.

Pooled Trust Preferred Securities

At June 30, 2018, our securities portfolio contained two pooled trust preferred securities with a fair value of \$8.2 million and unrealized losses of \$5.7 million. These securities are not subject to FASB ASC 325-10 and are evaluated using collateral-specific assumptions to estimate the expected future interest and principal cash flows. For the six months ended June 30, 2018 and 2017, our analysis indicated no OTTI on these securities.

During the first quarter of 2018, Old National sold a pooled trust security that fell within the scope of FASB ASC 325-10 (EITF 99-20). Proceeds from the sale were \$1.8 million, which resulted in a loss of \$0.9 million. Although Old National typically does not sell securities in an unrealized loss position, this security was sold because the final liquidation value was significantly higher than our assessment of value for this position.

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The table below summarizes the relevant characteristics of our pooled trust preferred securities as well as our single issuer trust preferred securities that are included in the other securities category in this footnote. Each of the pooled trust preferred securities support a more senior tranche of security holders. Both pooled trust preferred securities have experienced credit defaults. However, these securities have excess subordination and are not other-than-temporarily impaired as a result of their class hierarchy, which provides more loss protection.

Trust preferred securities June 30, 2018 (dollars in thousands)	Lowest Credit Class	Amortized Cost	Fair Value	Unrealized Gain/ Loss	Realized Losses 2018	# of Issuers Currently Performing Remaining	Actual	Expected	Excess
							Deferrals and Defaults	Default a % of	Subordination as a % of
	Rating (1)						% of Remaining Collateral	% of Remaining Collateral	% of Current Collateral
Pooled trust preferred securities:									
Pretsl XXVII LTD	B	\$ 4,382	\$ 2,602	\$ (1,780)	\$	35/44	16.7%	4.2%	46.1%
Trapeza Ser 13A	A2A	9,505	5,603	(3,902)		48/53	4.5%	4.7%	45.5%
		13,887	8,205	(5,682)					
Single Issuer trust preferred securities:									
JP Morgan Chase Cap XIII	BBB-	4,783	4,550	(233)					
Total		\$ 18,670	\$ 12,755	\$ (5,915)	\$				

(1) Lowest rating for the security provided by any nationally recognized credit rating agency.

NOTE 7 LOANS HELD FOR SALE

Mortgage loans held for immediate sale in the secondary market were \$26.2 million at June 30, 2018, compared to \$17.9 million at December 31, 2017. Residential loans that Old National has originated with the intent to sell are recorded at fair value in accordance with FASB ASC 825-10, *Financial Instruments*. Conventional mortgage production is sold on a servicing retained basis. Certain loans, such as government guaranteed mortgage loans are sold on servicing released basis.

NOTE 8 LOANS AND ALLOWANCE FOR LOAN LOSSES

Old National's loans consist primarily of loans made to consumers and commercial clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling, and retailing. Most of Old National's lending activity occurs within our principal geographic markets of Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. Old National manages concentrations of credit exposure by industry, product, geography, customer relationship, and loan size. While loans to lessors of both residential and non-residential real estate exceed 10% of total loans, no individual sub-segment category within those broader categories reaches the 10% threshold.

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The composition of loans by lending classification was as follows:

(dollars in thousands)	June 30, 2018	December 31, 2017
Commercial (1)	\$ 2,962,895	\$ 2,717,269
Commercial real estate:		
Construction	490,990	374,306
Other	3,960,782	3,980,246
Residential real estate	2,153,973	2,167,053
Consumer credit:		
Home equity	488,038	507,507
Auto	1,099,745	1,148,672
Other	139,206	223,068
Total loans	11,295,629	11,118,121
Allowance for loan losses	(53,660)	(50,381)
Net loans	\$ 11,241,969	\$ 11,067,740

(1) Includes direct finance leases of \$24.8 million at June 30, 2018 and \$29.5 million at December 31, 2017. The risk characteristics of each loan portfolio segment are as follows:

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate

These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. The properties securing Old National's commercial real estate portfolio are diverse in terms of type and geographic location. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Included with commercial real estate are construction loans, which are underwritten utilizing independent appraisal reviews, sensitivity analysis of absorption and lease rates, financial analysis of the developers and property owners, and feasibility studies, if available. Construction loans are generally based on estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders (including Old National), sales of developed property, or an interim loan commitment from Old National until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long-term financing.

The acquisition of Anchor (MN) on November 1, 2017 added \$864.4 million of commercial real estate loans to our portfolio. At 208%, Old National Bank's commercial real estate loans as a percentage of its risk-based capital remained well below the regulatory guideline limit of 300% at June 30, 2018.

Table of Contents**Residential**

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, Old National typically establishes a maximum loan-to-value ratio and generally requires private mortgage insurance if that ratio is exceeded. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Consumer

Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property or other collateral values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers. Old National assumed student loans in the acquisition of Anchor (WI) in May 2016. Student loans are guaranteed by the government from 97% to 100% and totaled \$68.2 million at December 31, 2017. Old National sold the remaining student loan portfolio totaling \$64.9 million during the second quarter of 2018, resulting in a \$2.2 million gain that is included in other income on the income statement.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses incurred in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience. The allowance is increased through a provision charged to operating expense. Loans deemed to be uncollectible are charged to the allowance. Recoveries of loans previously charged-off are added to the allowance.

We utilize a PD and LGD model as a tool to determine the adequacy of the allowance for loan losses for performing commercial and commercial real estate loans. The PD is forecast using a transition matrix to determine the likelihood of a customer's AQR migrating from its current AQR to any other status within the time horizon. Transition rates are measured using Old National's own historical experience. The model assumes that recent historical transition rates will continue into the future. The LGD is defined as credit loss incurred when an obligor of the bank defaults. The sum of all net charge-offs for a particular portfolio segment are divided by all loans that have defaulted over a given period of time. The expected loss derived from the model considers the PD, LGD, and exposure at default. Additionally, qualitative factors, such as changes in lending policies or procedures, and economic business conditions are also considered.

We use historic loss ratios adjusted for economic conditions to determine the appropriate level of allowance for residential real estate and consumer loans.

No allowance was brought forward on any of the acquired loans as any credit deterioration evident in the loans was included in the determination of the fair value of the loans at the acquisition date. An allowance for loan losses will be established for any subsequent credit deterioration or adverse changes in expected cash flows.

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Old National's activity in the allowance for loan losses for the three and six months ended June 30, 2018 and 2017 was as follows:

(dollars in thousands)	Commercial	Commercial Real Estate	Residential	Consumer	Total
Three Months Ended June 30, 2018					
Balance at beginning of period	\$ 19,591	\$ 20,796	\$ 1,763	\$ 8,231	\$ 50,381
Charge-offs	(472)	(430)	(295)	(1,857)	(3,054)
Recoveries	249	583	1,697	1,358	3,887
Provision	2,019	1,549	(1,298)	176	2,446
Balance at end of period	\$ 21,387	\$ 22,498	\$ 1,867	\$ 7,908	\$ 53,660
Three Months Ended June 30, 2017					
Balance at beginning of period	\$ 22,108	\$ 17,953	\$ 1,736	\$ 8,037	\$ 49,834
Charge-offs	(411)	(1,068)	(313)	(1,588)	(3,380)
Recoveries	789	1,522	28	838	3,177
Provision	(2,121)	2,247	360	869	1,355
Balance at end of period	\$ 20,365	\$ 20,654	\$ 1,811	\$ 8,156	\$ 50,986
Six Months Ended June 30, 2018					
Balance at beginning of period	\$ 19,246	\$ 21,436	\$ 1,763	\$ 7,936	\$ 50,381
Charge-offs	(717)	(433)	(657)	(3,932)	(5,739)
Recoveries	760	1,067	1,845	2,520	6,192
Provision	2,098	428	(1,084)	1,384	2,826
Balance at end of period	\$ 21,387	\$ 22,498	\$ 1,867	\$ 7,908	\$ 53,660
Six Months Ended June 30, 2017					
Balance at beginning of period	\$ 21,481	\$ 18,173	\$ 1,643	\$ 8,511	\$ 49,808
Charge-offs	(881)	(1,636)	(727)	(3,375)	(6,619)
Recoveries	1,392	2,747	107	1,849	6,095
Provision	(1,627)	1,370	788	1,171	1,702
Balance at end of period	\$ 20,365	\$ 20,654	\$ 1,811	\$ 8,156	\$ 50,986

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The following table provides Old National's recorded investment in loans by portfolio segment at June 30, 2018 and December 31, 2017 and other information regarding the allowance:

(dollars in thousands)	Commercial	Commercial Real Estate	Residential	Consumer	Total
June 30, 2018					
Allowance for loan losses:					
Individually evaluated for impairment	\$ 5,871	\$ 8,162	\$	\$	\$ 14,033
Collectively evaluated for impairment	15,409	14,267	1,865	7,760	39,301
Loans acquired with deteriorated credit quality	107	69	2	148	326
Total allowance for loan losses	\$ 21,387	\$ 22,498	\$ 1,867	\$ 7,908	\$ 53,660
Loans and leases outstanding:					
Individually evaluated for impairment	\$ 34,055	\$ 75,320	\$	\$	\$ 109,375
Collectively evaluated for impairment	2,924,481	4,355,891	2,143,658	1,722,747	11,146,777
Loans acquired with deteriorated credit quality	4,359	20,561	10,315	4,242	39,477
Total loans and leases outstanding	\$ 2,962,895	\$ 4,451,772	\$ 2,153,973	\$ 1,726,989	\$ 11,295,629
December 31, 2017					
Allowance for loan losses:					
Individually evaluated for impairment	\$ 3,424	\$ 6,654	\$	\$	\$ 10,078
Collectively evaluated for impairment	15,790	14,782	1,763	7,802	40,137
Loans acquired with deteriorated credit quality	32			134	166
Total allowance for loan losses	\$ 19,246	\$ 21,436	\$ 1,763	\$ 7,936	\$ 50,381
Loans and leases outstanding:					
Individually evaluated for impairment	\$ 26,270	\$ 66,061	\$	\$	\$ 92,331
Collectively evaluated for impairment	2,685,847	4,266,665	2,155,750	1,874,002	10,982,264
Loans acquired with deteriorated credit quality	5,152	21,826	11,303	5,245	43,526
Total loans and leases outstanding	\$ 2,717,269	\$ 4,354,552	\$ 2,167,053	\$ 1,879,247	\$ 11,118,121

Credit Quality

Old National's management monitors the credit quality of its loans in an on-going manner. Internally, management assigns an AQR to each non-homogeneous commercial and commercial real estate loan in the portfolio, with the exception of certain FICO-scored small business loans. The primary determinants of the AQR are based upon the reliability of the primary source of repayment and the past, present, and projected financial condition of the borrower. The AQR will also consider current industry conditions. Major factors used in determining the AQR can vary based

on the nature of the loan, but commonly include factors such as debt service coverage, internal cash flow, liquidity, leverage, operating performance, debt burden, FICO scores, occupancy, interest rate sensitivity, and expense burden. Old National uses the following definitions for risk ratings:

Criticized. Special mention loans that have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Classified Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Classified Nonaccrual. Loans classified as nonaccrual have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, in doubt.

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Classified Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as nonaccrual, with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Pass rated loans are those loans that are other than criticized, classified substandard, classified nonaccrual, or classified doubtful.

The risk category of commercial and commercial real estate loans by class of loans at June 30, 2018 and December 31, 2017 was as follows:

(dollars in thousands)	Commercial		Commercial Real Estate - Construction		Commercial Real Estate - Other	
Corporate Credit Exposure						
Credit Risk Profile by						
Internally Assigned Grade	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Grade:						
Pass	\$ 2,815,085	\$ 2,577,824	\$ 467,663	\$ 357,438	\$ 3,765,884	\$ 3,762,896
Criticized	70,168	74,876	14,882	14,758	69,841	98,451
Classified - substandard	41,382	37,367			62,595	58,584
Classified - nonaccrual	29,390	24,798	8,445	2,110	28,376	30,108
Classified - doubtful	6,870	2,404			34,086	30,207
Total	\$ 2,962,895	\$ 2,717,269	\$ 490,990	\$ 374,306	\$ 3,960,782	\$ 3,980,246

Old National considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, Old National also evaluates credit quality based on the aging status of the loan and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity at June 30, 2018 and December 31, 2017:

(dollars in thousands)	Residential	Home Equity	Consumer	
			Auto	Other
June 30, 2018				
Performing	\$ 2,130,775	\$ 483,350	\$ 1,097,256	\$ 137,666
Nonperforming	23,198	4,688	2,489	1,540
Total	\$ 2,153,973	\$ 488,038	\$ 1,099,745	\$ 139,206
December 31, 2017				
Performing	\$ 2,144,882	\$ 502,322	\$ 1,145,977	\$ 217,819
Nonperforming	22,171	5,185	2,695	5,249

Total	\$ 2,167,053	\$ 507,507	\$ 1,148,672	\$ 223,068
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Impaired Loans

Large commercial credits are subject to individual evaluation for impairment. Retail credits and other small balance credits that are part of a homogeneous group are not tested for individual impairment unless they are modified as a TDR. A loan is considered impaired when it is probable that contractual interest and principal payments will not be collected either for the amounts or by the dates as scheduled in the loan agreement. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Old National's policy, for all but PCI loans, is to recognize interest income on impaired loans unless the loan is placed on nonaccrual status.

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The following table shows Old National's impaired loans at June 30, 2018 and December 31, 2017, respectively. Only purchased loans that have experienced subsequent impairment since the date acquired (excluding loans acquired with deteriorated credit quality) are included in the table below.

(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
June 30, 2018			
With no related allowance recorded:			
Commercial	\$ 19,587	\$ 20,337	\$
Commercial Real Estate - Other	44,862	48,214	
Residential	2,271	2,292	
Consumer	1,483	1,601	
With an allowance recorded:			
Commercial	14,468	14,520	5,871
Commercial Real Estate - Construction	8,445	9,249	2,680
Commercial Real Estate - Other	22,013	22,065	5,482
Residential	935	935	47
Consumer	1,917	1,917	96
Total	\$ 115,981	\$ 121,130	\$ 14,176
December 31, 2017			
With no related allowance recorded:			
Commercial	\$ 20,557	\$ 21,483	\$
Commercial Real Estate - Other	38,678	44,564	
Residential	2,443	2,464	
Consumer	1,685	2,105	
With an allowance recorded:			
Commercial	5,713	5,713	3,424
Commercial Real Estate - Construction	905	1,371	401
Commercial Real Estate - Other	26,478	26,902	6,253
Residential	870	870	44
Consumer	2,211	2,228	110
Total	\$ 99,540	\$ 107,700	\$ 10,232

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The average balance of impaired loans during the three and six months ended June 30, 2018 and 2017 are included in the table below.

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Average Recorded Investment				
With no related allowance recorded:				
Commercial	\$ 20,228	\$ 25,817	\$ 20,073	\$ 26,038
Commercial Real Estate - Other	43,893	34,682	41,771	32,598
Residential	2,189	2,376	2,274	2,121
Consumer	1,741	1,717	1,722	1,420
With an allowance recorded:				
Commercial	11,846	8,448	10,091	7,996
Commercial Real Estate - Construction	4,675		4,675	
Commercial Real Estate - Other	21,439	22,916	24,246	28,911
Residential	942	1,147	918	1,125
Consumer	1,970	2,069	2,050	2,021
Total	\$ 108,923	\$ 99,172	\$ 107,820	\$ 102,230

Old National does not record interest on nonaccrual loans until principal is recovered. Interest income recognized on impaired loans during the three and six months ended June 30, 2018 and 2017 was immaterial.

For all loan classes, a loan is generally placed on nonaccrual status when principal or interest becomes 90 days past due unless it is well secured and in the process of collection, or earlier when concern exists as to the ultimate collectibility of principal or interest. Interest accrued during the current year on such loans is reversed against earnings. Interest accrued in the prior year, if any, is charged to the allowance for loan losses. Cash interest received on these loans is applied to the principal balance until the principal is recovered or until the loan returns to accrual status. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current, remain current for a prescribed period, and future payments are reasonably assured.

Loans accounted for under FASB ASC Topic 310-30 accrue interest, even though they may be contractually past due, as any nonpayment of contractual principal or interest is considered in the periodic re-estimation of expected cash flows and is included in the resulting recognition of current period loan loss provision or prospective yield adjustments.

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Old National's past due financing receivables at June 30, 2018 and December 31, 2017 were as follows:

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More and Accruing	Nonaccrual (1)	Total Past Due	Current
June 30, 2018						
Commercial	\$ 1,118	\$ 3	\$ 85	\$ 36,260	\$ 37,466	\$ 2,925,429
Commercial Real Estate:						
Construction				8,445	8,445	482,545
Other	378	953		62,462	63,793	3,896,989
Residential	21,871	4,563	389	23,198	50,021	2,103,952
Consumer:						
Home equity	780	1,043	627	4,688	7,138	480,900
Auto	5,584	1,259	319	2,489	9,651	1,090,094
Other	330	379	155	1,540	2,404	136,802
Total loans	\$ 30,061	\$ 8,200	\$ 1,575	\$ 139,082	\$ 178,918	\$ 11,116,711
December 31, 2017						
Commercial	\$ 986	\$ 360	\$ 144	\$ 27,202	\$ 28,692	\$ 2,688,577
Commercial Real Estate:						
Construction				2,110	2,110	372,196
Other	2,247	89		60,315	62,651	3,917,595
Residential	18,948	3,416		22,171	44,535	2,122,518
Consumer:						
Home equity	1,467	230	68	5,185	6,950	500,557
Auto	6,487	1,402	532	2,695	11,116	1,137,556
Other	3,967	1,514	150	5,249	10,880	212,188
Total loans	\$ 34,102	\$ 7,011	\$ 894	\$ 124,927	\$ 166,934	\$ 10,951,187

(1) Includes purchased credit impaired loans of \$11.3 million at June 30, 2018 and \$12.6 million at December 31, 2017 that are categorized as nonaccrual for credit analysis purposes because the collection of principal or interest is doubtful. However, these loans are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.

Loan Participations

Old National has loan participations, which qualify as participating interests, with other financial institutions. At June 30, 2018, these loans totaled \$820.2 million, of which \$412.8 million had been sold to other financial institutions and \$407.4 million was retained by Old National. The loan participations convey proportionate ownership rights with equal priority to each participating interest holder; involve no recourse (other than ordinary representations and warranties) to, or subordination by, any participating interest holder; all cash flows are divided among the

participating interest holders in proportion to each holder's share of ownership; and no holder has the right to pledge the entire financial asset unless all participating interest holders agree.

Troubled Debt Restructurings

Old National may choose to restructure the contractual terms of certain loans. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit Old National by increasing the ultimate probability of collection.

Any loans that are modified are reviewed by Old National to identify if a TDR has occurred, which is when for economic or legal reasons related to a borrower's financial difficulties, Old National Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status. The modification of the terms of such loans include one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate of new debt with similar risk, or a permanent reduction of the recorded investment of the loan.

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Loans modified in a TDR are typically placed on nonaccrual status until we determine the future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate a period of performance according to the restructured terms for six months.

If we are unable to resolve a nonperforming loan issue, the credit will be charged off when it is apparent there will be a loss. For large commercial type loans, each relationship is individually analyzed for evidence of apparent loss based on quantitative benchmarks or subjectively based upon certain events or particular circumstances. Generally, Old National charges off small commercial loans scored through our small business credit center with contractual balances under \$250,000 that are 90 days or more delinquent and do not have adequate collateral support. For residential and consumer loans, a charge off is recorded at the time foreclosure is initiated or when the loan becomes 120 to 180 days past due, whichever is earlier.

For commercial TDRs, an allocated reserve is established within the allowance for loan losses for the difference between the carrying value of the loan and its computed value. To determine the value of the loan, one of the following methods is selected: (1) the present value of expected cash flows discounted at the loan's original effective interest rate, (2) the loan's observable market price, or (3) the fair value of the collateral value, if the loan is collateral dependent. The allocated reserve is established as the difference between the carrying value of the loan and the collectable value. If there are significant changes in the amount or timing of the loan's expected future cash flows, impairment is recalculated and the valuation allowance is adjusted accordingly.

When a residential or consumer loan is identified as a TDR, the loan is typically written down to its collateral value less selling costs.

The following table presents activity in TDRs for the six months ended June 30, 2018 and 2017:

(dollars in thousands)	Commercial	Commercial Real Estate	Residential	Consumer	Total
Six Months Ended June 30, 2018					
Balance at beginning of period	\$ 12,088	\$ 34,705	\$ 3,315	\$ 3,895	\$ 54,003
(Charge-offs)/recoveries	(151)	(22)	23	(22)	(172)
Payments	(3,978)	(969)	(69)	(907)	(5,923)
Additions	1,084	1,213	502	432	3,231
Balance at end of period	\$ 9,043	\$ 34,927	\$ 3,771	\$ 3,398	\$ 51,139
Six Months Ended June 30, 2017					
Balance at beginning of period	\$ 16,802	\$ 18,327	\$ 2,985	\$ 2,602	\$ 40,716
(Charge-offs)/recoveries	(64)	360		(97)	199
Payments	(6,116)	(3,057)	(283)	(785)	(10,241)
Additions	9,442	17,429	938	1,924	29,733
Balance at end of period	\$ 20,064	\$ 33,059	\$ 3,640	\$ 3,644	\$ 60,407

TDRs included with nonaccrual loans totaled \$34.0 million at June 30, 2018 and December 31, 2017. Old National has allocated specific reserves to customers whose loan terms have been modified in TDRs totaling \$4.8 million at

June 30, 2018 and \$5.7 million at December 31, 2017. At June 30, 2018, Old National had committed to lend an additional \$4.0 million to customers with outstanding loans that are classified as TDRs.

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The pre-modification and post-modification outstanding recorded investments of loans modified as TDRs during the six months ended June 30, 2018 and 2017 are the same except for when the loan modifications involve the forgiveness of principal. The following table presents loans by class modified as TDRs that occurred during the six months ended June 30, 2018 and 2017:

(dollars in thousands)	Pre-modification Number Outstanding of Loans	Pre-modification Recorded Investment	Post-modification Outstanding Recorded Investment
Six Months Ended June 30, 2018			
TDR:			
Commercial	2	\$ 1,084	\$ 1,084
Commercial Real Estate - Other	2	1,213	1,213
Residential	1	502	502
Consumer	1	432	432
Total	6	\$ 3,231	\$ 3,231
Six Months Ended June 30, 2017			
TDR:			
Commercial	6	\$ 9,442	\$ 9,442
Commercial Real Estate - Other	10	17,429	17,429
Residential	6	938	938
Consumer	5	1,924	1,924
Total	27	\$ 29,733	\$ 29,733

The TDRs that occurred during the six months ended June 30, 2018 did not have a material impact on the allowance for loan losses and resulted in no charge-offs during the six months ended June 30, 2018. The TDRs that occurred during the six months ended June 30, 2017 increased the allowance for loan losses by \$3.4 million and resulted in no charge-offs.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

TDRs for which there was a payment default within twelve months following the modification were insignificant during the six months ended June 30, 2018 and 2017.

The terms of certain other loans were modified during 2018 that did not meet the definition of a TDR. It is our process to review all classified and criticized loans that, during the period, have been renewed, have entered into a forbearance agreement, have gone from principal and interest to interest only, or have extended the maturity date. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on its debt in the foreseeable future without the modification. The evaluation is performed under our internal underwriting policy. We also evaluate whether a concession has been granted or if we were adequately compensated through a market interest rate, additional collateral or a bona fide guarantee. We also consider whether the modification was insignificant relative to the other terms of the agreement or the delay in a payment.

PCI loans are not considered impaired until after the point at which there has been a degradation of cash flows below our expected cash flows at acquisition. If a PCI loan is subsequently modified, and meets the definition of a TDR, it will be removed from PCI accounting and accounted for as a TDR only if the PCI loan was being accounted for individually. If the PCI loan is being accounted for as part of a pool, it will not be removed from the pool. As of June 30, 2018, it has not been necessary to remove any loans from PCI accounting.

In general, once a modified loan is considered a TDR, the loan will always be considered a TDR, and therefore impaired, until it is paid in full, otherwise settled, sold or charged off. However, guidance also permits for loans to be removed from TDR status when subsequently restructured under these circumstances: (1) at the time of the subsequent restructuring, the borrower is not experiencing financial difficulties, and this is documented by a current

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credit evaluation at the time of the restructuring, (2) under the terms of the subsequent restructuring agreement, the institution has granted no concession to the borrower; and (3) the subsequent restructuring agreement includes market terms that are no less favorable than those that would be offered for a comparable new loan. For loans subsequently restructured that have cumulative principal forgiveness, the loan should continue to be measured in accordance with ASC 310-10, *Receivables – Overall*. However, consistent with ASC 310-40-50-2, *Troubled Debt Restructurings by Creditors, Creditor Disclosure of Troubled Debt Restructurings*, the loan would not be required to be reported in the years following the restructuring if the subsequent restructuring meets both of these criteria: (1) has an interest rate at the time of the subsequent restructuring that is not less than a market interest rate; and (2) is performing in compliance with its modified terms after the subsequent restructuring.

Purchased Credit Impaired Loans

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan and lease losses. In determining the estimated fair value of purchased loans, management considers a number of factors including, among others, the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, and net present value of cash flows expected to be received. Purchased loans are accounted for in accordance with guidance for certain loans acquired in a transfer (ASC 310-30), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan and lease losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income prospectively.

Old National has purchased loans for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. For these loans that meet the criteria of ASC 310-30 treatment, the carrying amount was as follows:

(dollars in thousands)	June 30, 2018	December 31, 2017
Commercial	\$ 4,359	\$ 5,152
Commercial real estate	20,561	21,826
Residential	4,242	11,303
Consumer	10,315	5,245
Carrying amount	39,477	43,526
Allowance for loan losses	(326)	(166)
Carrying amount, net of allowance	\$ 39,151	\$ 43,360

The outstanding balance of loans accounted for under ASC 310-30, including contractual principal, interest, fees and penalties, was \$240.9 million at June 30, 2018 and \$235.9 million at December 31, 2017.

The accretable difference on PCI loans is the difference between the expected cash flows and the net present value of expected cash flows with such difference accreted into earnings using the effective yield method over the term of the

loans. Accretion recorded as loan interest income totaled \$7.1 million during the six months ended June 30, 2018 and \$7.3 million during the six months ended June 30, 2017. Improvement in cash flow expectations has resulted in a reclassification from nonaccretable difference to accretable yield as shown in the table below.

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Accretable yield of PCI loans, or income expected to be collected, is as follows:

(dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Balance at beginning of period	\$ 27,835	\$ 33,603
Accretion of income	(7,073)	(7,330)
Reclassifications from (to) nonaccretable difference	3,466	594
Disposals/other adjustments	21	183
Balance at end of period	\$ 24,249	\$ 27,050

Included in Old National's allowance for loan losses is \$0.3 million related to the purchased loans disclosed above at June 30, 2018 and \$0.2 million at December 31, 2017.

PCI loans purchased during 2017 for which it was probable at acquisition that all contractually required payments would not be collected were as follows:

(dollars in thousands)	Anchor (MN) (1)
Contractually required payments	\$ 16,898
Nonaccretable difference	(4,787)
Cash flows expected to be collected at acquisition	12,111
Accretable yield	(1,556)
Fair value of acquired loans at acquisition	\$ 10,555

(1) Old National acquired Anchor (MN) effective November 1, 2017.

Income would not be recognized on certain purchased loans if Old National could not reasonably estimate cash flows to be collected. Old National had no purchased loans for which it could not reasonably estimate cash flows to be collected.

NOTE 9 OTHER REAL ESTATE OWNED

The following table presents activity in other real estate owned for the six months ended June 30, 2018 and 2017:

(dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Balance at beginning of period	\$ 8,810	\$ 18,546

Additions	1,175	950
Sales	(5,625)	(6,552)
Impairment	(631)	(1,873)
Balance at end of period (1)	\$ 3,729	\$ 11,071

(1) Includes repossessed personal property of \$0.3 million at June 30, 2018 and \$0.2 million at June 30, 2017. At June 30, 2018, foreclosed residential real estate property included in the table above totaled \$1.3 million. At June 30, 2018, consumer mortgage loans collateralized by residential real property that were in the process of foreclosure totaled \$6.3 million.

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The composition of premises and equipment at June 30, 2018 and December 31, 2017 was as follows:

(dollars in thousands)	June 30, 2018	December 31, 2017
Land	\$ 70,628	\$ 73,046
Buildings	339,378	343,833
Furniture, fixtures, and equipment	98,793	94,254
Leasehold improvements	40,165	38,918
Total	548,964	550,051
Accumulated depreciation	(99,660)	(91,977)
Premises and equipment, net	\$ 449,304	\$ 458,074

Depreciation expense was \$5.9 million for the three months ended June 30, 2018 and \$11.8 million for the six months ended June 30, 2018, compared to \$5.2 million for the three months ended June 30, 2017 and \$10.4 million for the six months ended June 30, 2017.

Operating Leases

Old National rents certain premises and equipment under operating leases, which expire at various dates. Many of these leases require the payment of property taxes, insurance premiums, maintenance, and other costs. In some cases, rentals are subject to increase in relation to a cost-of-living index. The leases have original terms ranging from two years and six months to twenty-five years, and Old National has the right, at its option, to extend the terms of certain leases for four additional successive terms of five years. Old National does not have any material sub-lease agreements. Rent expense was \$4.5 million for the three months ended June 30, 2018 and \$8.9 million for the six months ended June 30, 2018, compared to \$3.8 million for the three months ended June 30, 2017 and \$7.7 million for the six months ended June 30, 2017.

Old National had deferred gains remaining associated with prior sale leaseback transactions totaling \$7.3 million at June 30, 2018 and \$8.2 million at December 31, 2017. The gains will be recognized over the remaining term of the leases. The leases had original terms ranging from five to twenty-four years.

Capital Leases

Old National leases two branch buildings and certain equipment under capital leases. See Note 16 to the consolidated financial statements for detail regarding these leases.

NOTE 11 GOODWILL AND OTHER INTANGIBLE ASSETS

The following table shows the changes in the carrying amount of goodwill for the six months ended June 30, 2018 and 2017:

(dollars in thousands)	Six Months Ended	
	June 30,	
	2018	2017
Balance at beginning of period	\$ 828,051	\$ 655,018
Acquisition adjustments	753	
Balance at end of period	\$ 828,804	\$ 655,018

Goodwill is reviewed annually for impairment. No events or circumstances since the August 31, 2017 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists. During the six months ended June 30, 2018, Old National recorded a \$0.8 million increase to goodwill associated with the acquisition of Anchor (MN).

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The gross carrying amount and accumulated amortization of other intangible assets at June 30, 2018 and December 31, 2017 were as follows:

(dollars in thousands)	Gross Carrying Amount	Accumulated Amortization and Impairment	Net Carrying Amount
June 30, 2018			
Core deposit	\$ 108,268	\$ (69,065)	\$ 39,203
Customer trust relationships	16,547	(10,333)	6,214
Total intangible assets	\$ 124,815	\$ (79,398)	\$ 45,417
December 31, 2017			
Core deposit	\$ 108,923	\$ (62,874)	\$ 46,049
Customer trust relationships	16,547	(9,533)	7,014
Customer loan relationships	4,413	(4,380)	33
Total intangible assets	\$ 129,883	\$ (76,787)	\$ 53,096

Other intangible assets consist of core deposit intangibles and customer relationship intangibles and are being amortized primarily on an accelerated basis over their estimated useful lives, generally over a period of 5 to 15 years. During the six months ended June 30, 2018, Old National recorded a \$0.7 million decrease to core deposit intangibles related to the updated valuation associated with the acquisition of Anchor (MN).

Old National reviews other intangible assets for possible impairment whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. No impairment charges were recorded during the six months ended June 30, 2018 or 2017. Total amortization expense associated with intangible assets was \$7.0 million for the six months ended June 30, 2018 and \$5.8 million for the six months ended June 30, 2017.

Estimated amortization expense for future years is as follows:

(dollars in thousands)	
2018 remaining	\$ 6,399
2019	11,010
2020	8,672
2021	6,417
2022	4,595
Thereafter	8,324
Total	\$ 45,417

NOTE 12 LOAN SERVICING RIGHTS

At June 30, 2018, loan servicing rights derived from loans sold with servicing retained totaled \$24.3 million, compared to \$24.7 million at December 31, 2017. Loans serviced for others are not reported as assets. The principal balance of loans serviced for others was \$3.306 billion at June 30, 2018, compared to \$3.321 billion at December 31, 2017. Approximately 99.7% of the loans serviced for others at June 30, 2018 were residential mortgage loans. Custodial escrow balances maintained in connection with serviced loans were \$37.8 million at June 30, 2018 and \$8.9 million at December 31, 2017.

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The following table summarizes the carrying values and activity related to loan servicing rights and the related valuation allowance for the six months ended June 30, 2018 and 2017:

(dollars in thousands)	Six Months Ended	
	June 30,	
	2018	2017
Balance at beginning of period	\$ 24,690	\$ 25,629
Additions	1,951	1,976
Amortization	(2,323)	(2,507)
Balance before valuation allowance at end of period	24,318	25,098
Valuation allowance:		
Balance at beginning of period	(29)	(68)
(Additions)/recoveries	14	(7)
Balance at end of period	(15)	(75)
Loan servicing rights, net	\$ 24,303	\$ 25,023

At June 30, 2018, the fair value of servicing rights was \$27.0 million, which was determined using a discount rate of 13% and a weighted average prepayment speed of 115% PSA. At December 31, 2017, the fair value of servicing rights was \$25.8 million, which was determined using a discount rate of 13% and a weighted average prepayment speed of 140% PSA.

NOTE 13 QUALIFIED AFFORDABLE HOUSING PROJECTS AND OTHER TAX CREDIT INVESTMENTS

Old National is a limited partner in several tax-advantaged limited partnerships whose purpose is to invest in approved qualified affordable housing, renewable energy, or other renovation or community revitalization projects. As of June 30, 2018, Old National expects to recover its remaining investments using the tax credits that are generated by the investments.

The following table summarizes Old National's investments in qualified affordable housing projects and other tax credit investments at June 30, 2018 and December 31, 2017:

(dollars in thousands)	Accounting Method	June 30, 2018		December 31, 2017	
		Investment	Unfunded Commitment (1)	Investment	Unfunded Commitment
LIHTC	Proportional amortization	\$ 29,802	\$ 6,719	\$ 31,183	\$ 15,553
FHTC	Equity	5,201	10,710	10,645	12,040
CReED	Equity	704	1,502	704	1,502
Renewable Energy	Equity	15,136	18,588	22,364	19,771

Total	\$ 50,843	\$ 37,519	\$ 64,896	\$ 48,866
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(1) All commitments will be paid by Old National by 2027.

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The following table summarizes the amortization expense and tax benefit recognized for Old National's qualified affordable housing projects and other tax credit investments for the three and six months ended June 30, 2018 and 2017:

(dollars in thousands)	Amortization Expense (1)	Tax Expense (Benefit) Recognized (2)
Three Months Ended June 30, 2018		
LIHTC	\$ 643	\$ (831)
FHTC	5,444	(1,948)
Renewable Energy	6,414	(2,882)
Total	\$ 12,501	\$ (5,661)
Three Months Ended June 30, 2017		
LIHTC	\$ 940	\$ (1,298)
FHTC		(1,519)
CRoED (3)		(606)
Total	\$ 940	\$ (3,423)
Six Months Ended June 30, 2018		
LIHTC	\$ 1,282	\$ (1,662)
FHTC	5,444	(3,896)
Renewable Energy	7,129	(6,296)
Total	\$ 13,855	\$ (11,854)
Six Months Ended June 30, 2017		
LIHTC	\$ 1,881	\$ (2,595)
FHTC		(3,039)
CRoED (3)		(606)
Total	\$ 1,881	\$ (6,240)

- (1) The amortization expense for the LIHTC investments is included in our income tax expense. The amortization expense for the FHTC and Renewable Energy tax credits is included in noninterest expense.
- (2) All of the tax benefits recognized are included in our income tax expense. The tax benefit recognized for the FHTC and Renewable Energy investments primarily reflects the tax credits generated from the investments, and excludes the net tax expense (benefit) of the investments' income (loss).
- (3) The CRoED tax credit investment qualifies for an Indiana state tax credit.

NOTE 14 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase are secured borrowings. Old National pledges investment securities to secure these borrowings. The following table presents securities sold under agreements to repurchase and related weighted-average interest rates at or for the six months ended June 30:

(dollars in thousands)	2018	2017
Outstanding at June 30,	\$ 347,511	\$ 298,094
Average amount outstanding	337,612	330,285
Maximum amount outstanding at any month-end	347,511	351,897
Weighted average interest rate:		
During the six months ended June 30,	0.47%	0.36%
At June 30,	0.59	0.41

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The following table presents the contractual maturity of our secured borrowings and class of collateral pledged:

(dollars in thousands)	At June 30, 2018				Total
	Remaining Contractual Maturity of the Agreements		Greater Than		
	Overnight and	Up to	30-90 Days	90 days	
	Continuous	30 Days			
Repurchase Agreements:					
U.S. Treasury and agency securities	\$ 347,511	\$	\$	\$	\$ 347,511
Total	\$ 347,511	\$	\$	\$	\$ 347,511

The fair value of securities pledged to secure repurchase agreements may decline. Old National has pledged securities valued at 109% of the gross outstanding balance of repurchase agreements at June 30, 2018 to manage this risk.

NOTE 15 FEDERAL HOME LOAN BANK ADVANCES

The following table summarizes Old National Bank's FHLB advances at June 30, 2018 and December 31, 2017:

(dollars in thousands)	June 30, 2018	December 31, 2017
FHLB advances (fixed rates 1.50% to 6.08% and variable rates 2.23% to 2.50%) maturing July 2018 to June 2028	\$ 1,756,730	\$ 1,610,531
ASC 815 fair value hedge and other basis adjustments	578	(952)
Total other borrowings	\$ 1,757,308	\$ 1,609,579

FHLB advances had weighted-average rates of 2.29% at June 30, 2018 and 1.55% at December 31, 2017. Investment securities and residential real estate loans collateralize these borrowings up to 140% of outstanding debt.

Contractual maturities of FHLB advances at June 30, 2018 were as follows:

(dollars in thousands)	
Due in 2018	\$ 626,567
Due in 2019	201,494
Due in 2020	100,000
Due in 2021	20,000
Due in 2022	58,500
Thereafter	750,169
ASC 815 fair value hedge and other basis adjustments	578
Total	\$ 1,757,308

Table of Contents**NOTE 16 OTHER BORROWINGS**

The following table summarizes Old National's other borrowings at June 30, 2018 and December 31, 2017:

(dollars in thousands)	June 30, 2018	December 31, 2017
Old National Bancorp:		
Senior unsecured notes (fixed rate 4.125%) maturing August 2024	\$ 175,000	\$ 175,000
Unamortized debt issuance costs related to senior unsecured notes	(949)	(1,026)
Junior subordinated debentures (variable rates of 3.68% to 6.22%) maturing April 2032 to September 2037	60,310	60,310
Other basis adjustments	(3,318)	(3,585)
Old National Bank:		
Capital lease obligations	5,326	5,389
Subordinated debentures (fixed rate 5.75%)	12,000	12,000
Other	1,872	694
Total other borrowings	\$ 250,241	\$ 248,782

Contractual maturities of other borrowings at June 30, 2018 were as follows:

(dollars in thousands)	
Due in 2018	\$ 1,286
Due in 2019	137
Due in 2020	147
Due in 2021	160
Due in 2022	172
Thereafter	251,956
Unamortized debt issuance costs and other basis adjustments	(3,617)
Total	\$ 250,241

Senior Notes

In August 2014, Old National issued \$175.0 million of senior unsecured notes with a 4.125% interest rate. These notes pay interest on February 15 and August 15. The notes mature on August 15, 2024.

Junior Subordinated Debentures

Junior subordinated debentures related to trust preferred securities are classified in other borrowings. With the addition of Anchor (MN) assets, these securities now qualify as Tier 2 capital for regulatory purposes, subject to

certain limitations. Prior to the fourth quarter of 2017, these securities qualified as Tier 1 capital for regulatory purposes.

Through various acquisitions, Old National assumed junior subordinated debenture obligations related to various trusts that issued trust preferred securities. Old National guarantees the payment of distributions on the trust preferred securities issued by the trusts. Proceeds from the issuance of each of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by the trusts.

Old National, at any time, may redeem the junior subordinated debentures at par and, thereby cause a redemption of the trust preferred securities in whole or in part.

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The following table summarizes the terms of our outstanding junior subordinated debentures at June 30, 2018:

(dollars in thousands)

Name of Trust	Issuance		Rate	Rate at	Maturity Date
	Date	Amount		June 30,	
VFSC Capital Trust I	April 2002	\$ 3,093	3-month LIBOR plus 3.70%	6.22%	April 22, 2032
VFSC Capital Trust II	October 2002	4,124	3-month LIBOR plus 3.45%	5.79%	November 7, 2032
VFSC Capital Trust III	April 2004	3,093	3-month LIBOR plus 2.80%	5.12%	September 8, 2034
St. Joseph Capital Trust II	March 2005	5,000	3-month LIBOR plus 1.75%	4.08%	March 20, 2035
Anchor Capital Trust III	August 2005	5,000	3-month LIBOR plus 1.55%	3.89%	September 30, 2035
Tower Capital Trust 2	December 2005	8,000	3-month LIBOR plus 1.34%	3.68%	December 4, 2035
Home Federal Statutory Trust I	September 2006	15,000	3-month LIBOR plus 1.65%	3.99%	September 15, 2036
Monroe Bancorp Capital Trust I	July 2006	3,000	3-month LIBOR plus 1.60%	3.95%	October 7, 2036
Monroe Bancorp Statutory Trust II	March 2007	5,000	3-month LIBOR plus 1.60%	3.94%	June 15, 2037
Tower Capital Trust 3	December 2006	9,000	3-month LIBOR plus 1.69%	3.99%	September 15, 2037
Total		\$ 60,310			

Subordinated Debentures

On November 1, 2017, Old National assumed \$12.0 million of subordinated fixed-to-floating notes related to the acquisition of Anchor (MN). The subordinated debentures have a 5.75% fixed rate of interest through October 29, 2020. From October 30, 2020 to the October 30, 2025 maturity date, the debentures have a floating rate of interest equal to the three-month LIBOR rate plus 4.356%.

Capital Lease Obligations

On January 1, 2004, Old National entered into a long-term capital lease obligation for a branch office building in Owensboro, Kentucky, which extends for 25 years with one renewal option for 10 years. The economic substance of this lease is that Old National is financing the acquisition of the building through the lease and accordingly, the building is recorded as an asset and the lease is recorded as a liability. The fair value of the capital lease obligation was estimated using a discounted cash flow analysis based on Old National's current incremental borrowing rate for similar types of borrowing arrangements.

On May 1, 2016, Old National acquired Anchor (WI), assuming a five-year capital lease obligation for equipment.

On November 1, 2017, Old National assumed a capital lease obligation for a banking center in Arden Hills, Minnesota related to the acquisition of Anchor (MN). The remaining base term of the lease is five years with one renewal option of ten years. For purposes of measuring the lease obligation, we determined that we would be reasonably assured to exercise the renewal option. The fair value of the capital lease obligation was estimated using a discounted cash flow analysis based on a market rate for similar types of borrowing arrangements. Based on the above assumptions, Old National measured the capital lease obligation at \$1.5 million as of the date of acquisition.

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At June 30, 2018, the future minimum lease payments under the capital lease arrangements were as follows:

(dollars in thousands)	
2018	\$ 284
2019	589
2020	589
2021	589
2022	589
Thereafter	9,275
Total minimum lease payments	11,915
Less amounts representing interest	(6,589)
Present value of net minimum lease payments	\$ 5,326

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The following table summarizes the changes within each classification of AOCI, net of tax, for the three and six months ended June 30, 2018 and 2017:

(dollars in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Unrealized Gains and Losses on Held-to-Maturity Securities	Gains and Losses on Cash Flow Hedges	Defined Benefit Pension Plans	Total
Three Months Ended June 30, 2018					
Balance at beginning of period	\$ (52,605)	\$ (9,737)	\$ 1,126	\$ (310)	\$ (61,526)
Other comprehensive income (loss) before reclassifications	(5,615)		1,143		(4,472)
Amounts reclassified from AOCI to income (1)	(1,136)	402	8	21	(705)
Balance at end of period	\$ (59,356)	\$ (9,335)	\$ 2,277	\$ (289)	\$ (66,703)
Three Months Ended June 30, 2017					
Balance at beginning of period	\$ (29,992)	\$ (13,015)	\$ (5,240)	\$ (318)	\$ (48,565)
Other comprehensive income (loss) before reclassifications	19,492		(1,480)		18,012
Amounts reclassified from AOCI to income (1)	(1,957)	298	1,075	17	(567)
Balance at end of period	\$ (12,457)	\$ (12,717)	\$ (5,645)	\$ (301)	\$ (31,120)
Six Months Ended June 30, 2018					
Balance at beginning of period	\$ (35,557)	\$ (12,107)	\$ (2,337)	\$ (271)	\$ (50,272)
Other comprehensive income (loss) before reclassifications	(14,486)	4,514	4,587		(5,385)
Amounts reclassified from AOCI to income (1)	(1,730)	858	588	41	(243)
Amount reclassified from AOCI to retained earnings for cumulative effect of change in accounting principle (2)			(52)		(52)
Amounts reclassified from AOCI to retained earnings related to the Tax Cuts and Jobs Act of 2017 (3)	(7,583)	(2,600)	(509)	(59)	(10,751)
Balance at end of period	\$ (59,356)	\$ (9,335)	\$ 2,277	\$ (289)	\$ (66,703)
Six Months Ended June 30, 2017					
Balance at beginning of period	\$ (39,012)	\$ (13,310)	\$ (6,715)	\$ (335)	\$ (59,372)

Other comprehensive income (loss) before reclassifications	29,459		(1,120)		28,339
Amounts reclassified from AOCI to income (1)	(2,904)	593	2,190	34	(87)
Balance at end of period	\$ (12,457)	\$ (12,717)	\$ (5,645)	\$ (301)	\$ (31,120)

- (1) See table below for details about reclassifications to income.
- (2) See Note 3 for details about reclassification from AOCI to beginning retained earnings resulting from the adoption of ASU 2017-12.
- (3) See Note 3 for details about reclassification from AOCI to beginning retained earnings resulting from the adoption of ASU 2018-02.

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The following table summarizes the significant amounts reclassified out of each component of AOCI for the three months ended June 30, 2018 and 2017:

Details about AOCI Components	Amount Reclassified from AOCI Three Months Ended June 30,		Affected Line Item in the Statement of Income
	2018	2017	
(dollars in thousands)			
Unrealized gains and losses on available-for-sale securities	\$ 1,494 (358)	\$ 3,075 (1,118)	Net securities gains Income tax (expense) benefit
	\$ 1,136	\$ 1,957	Net income
Unrealized gains and losses on held-to-maturity securities	\$ (521) 119	\$ (453) 155	Interest income (expense) Income tax (expense) benefit
	\$ (402)	\$ (298)	Net income
Gains and losses on cash flow hedges			
Interest rate contracts	\$ (10) 2	\$ (1,734) 659	Interest income (expense) Income tax (expense) benefit
	\$ (8)	\$ (1,075)	Net income
Amortization of defined benefit pension items Actuarial gains (losses)	\$ (27) 6	\$ (27) 10	Salaries and employee benefits Income tax (expense) benefit
	\$ (21)	\$ (17)	Net income
Total reclassifications for the period	\$ 705	\$ 567	Net income

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The following table summarizes the significant amounts reclassified out of each component of AOCI for the six months ended June 30, 2018 and 2017:

Details about AOCI Components (dollars in thousands)	Amount Reclassified from AOCI Six Months Ended June 30,		Affected Line Item in the Statement of Income
	2018	2017	
Unrealized gains and losses on available-for-sale securities	\$ 2,282 (552)	\$ 4,575 (1,671)	Net securities gains Income tax (expense) benefit
	\$ 1,730	\$ 2,904	Net income
Unrealized gains and losses on held-to-maturity securities	\$ (1,112) 254	\$ (902) 309	Interest income/(expense) Income tax (expense) benefit
	\$ (858)	\$ (593)	Net income
Gains and losses on cash flow hedges Interest rate contracts	\$ (779) 191	\$ (3,533) 1,343	Interest income/(expense) Income tax (expense) benefit
	\$ (588)	\$ (2,190)	Net income
Amortization of defined benefit pension items Actuarial gains/(losses)	\$ (54) 13	\$ (54) 20	Salaries and employee benefits Income tax (expense) benefit
	\$ (41)	\$ (34)	Net income
Total reclassifications for the period	\$ 243	\$ 87	Net income

NOTE 18 EMPLOYEE BENEFIT PLANS**Retirement Plan**

Old National had a funded noncontributory defined benefit plan (the Retirement Plan) that had been frozen since December 31, 2005. During the first quarter of 2016, we notified plan participants of our intent to terminate the Retirement Plan effective May 15, 2016. During October 2016, the Retirement Plan settled plan liabilities through either lump sum distributions to plan participants or annuity contracts purchased from a third-party insurance company that provided for the payment of vested benefits to those participants that did not elect the lump sum option. At June 30, 2018, there were no remaining plan assets.

Employee Stock Ownership Plan

The Employee Stock Ownership and Savings Plan (the 401(k) Plan) permits employees to participate the first month following one month of service. During the second quarter of 2018, Old National increased its match to 75% of employee compensation deferral contributions of the first 4% of compensation, and 50% of the next 4% of compensation. The change was retroactive for all of 2018. For 2017, we matched 50% of employee compensation deferral contributions, up to 6% of compensation. Contribution expense under the 401(k) Plan was \$3.1 million in the three months ended June 30, 2018 and \$4.6 million in the six months ended June 30, 2018, compared to \$1.2 million in the three months ended June 30, 2017 and \$2.4 million in the six months ended June 30, 2017.

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NOTE 19 SHARE-BASED COMPENSATION

At June 30, 2018, Old National had 4.4 million shares remaining available for issuance under the Company's Amended and Restated 2008 Incentive Compensation Plan. The granting of awards to key employees is typically in the form of restricted stock awards or units.

Restricted Stock Awards

Old National granted 212 thousand time-based restricted stock awards to certain key officers during the six months ended June 30, 2018, with shares vesting generally over a thirty-six month period. Compensation expense is recognized on a straight-line basis over the vesting period. Shares are subject to certain restrictions and risk of forfeiture by the participants. At June 30, 2018, unrecognized compensation expense was estimated to be \$6.1 million for unvested restricted stock awards. The cost is expected to be recognized over a weighted-average period of 2.2 years.

Old National recorded share-based compensation expense, net of tax, related to restricted stock awards of \$1.1 million, net of tax, during the six months ended June 30, 2018, compared to \$0.9 million, net of tax, during the six months ended June 30, 2017.

Restricted Stock Units

Old National granted 288 thousand shares of performance based restricted stock units to certain key officers during the six months ended June 30, 2018, with shares vesting at the end of a thirty-six month period based on the achievement of certain targets. For certain awards, the level of performance could increase or decrease the percentage of shares earned. Compensation expense is recognized on a straight-line basis over the vesting period. Shares are subject to certain restrictions and risk of forfeiture by the participants. At June 30, 2018, unrecognized compensation expense was estimated to be \$5.8 million. The cost is expected to be recognized over a weighted-average period of 2.0 years.

Old National recorded share-based compensation expense, net of tax, related to restricted stock units of \$1.6 million during the six months ended June 30, 2018, compared to \$1.0 million during the six months ended June 30, 2017.

Stock Options

Old National has not granted stock options since 2009. However, Old National did acquire stock options through prior year acquisitions. Old National did not record any share-based compensation expense related to these stock options during the six months ended June 30, 2018 or 2017.

Stock Appreciation Rights

Old National has never granted stock appreciation rights. However, Old National did acquire stock appreciation rights through a prior year acquisition. Old National did not record any incremental expense associated with the conversion of these stock appreciation rights during the six months ended June 30, 2018 or 2017. At June 30, 2018, 62 thousand stock appreciation rights remained outstanding.

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Following is a summary of the major items comprising the differences in taxes from continuing operations computed at the federal statutory rate and as recorded in the consolidated statements of income:

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Provision at statutory rate (1)	\$ 10,153	\$ 17,303	\$ 21,270	\$ 33,572
Tax-exempt income:				
Tax-exempt interest	(2,237)	(3,672)	(4,428)	(7,374)
Section 291/265 interest disallowance	73	64	135	121
Company-owned life insurance income	(510)	(741)	(1,057)	(1,493)
Tax-exempt income	(2,674)	(4,349)	(5,350)	(8,746)
State income taxes	1,028	195	2,216	1,046
Interim period effective rate adjustment	933	(286)	1,025	(741)
Tax credit investments - federal	(4,973)	(1,877)	(10,741)	(3,753)
Other, net	(122)	(402)	882	(303)
Income tax expense	\$ 4,345	\$ 10,584	\$ 9,302	\$ 21,075
Effective tax rate	9.0%	21.4%	9.2%	22.0%

(1) The statutory rate was 21% for the three and six months ended June 30, 2018, compared to 35% for the three and six months ended June 30, 2017.

In accordance with ASC 740-270, *Accounting for Interim Reporting*, the provision for income taxes was recorded at June 30, 2018 and 2017 based on the current estimate of the effective annual rate.

The lower effective tax rate during the three and six months ended June 30, 2018 when compared to the three and six months ended June 30, 2017 is primarily the result of the lowering of the federal corporate tax rate to 21% in 2018 and an increase in federal tax credits available. On December 22, 2017, the Tax Cuts and Jobs Act (H.R. 1) was enacted into legislation. Under ASC 740, the effects of changes in tax rates and laws are recognized in the period in which the new legislation is enacted. Accordingly, Old National recorded an estimated \$39.3 million for the revaluation of Old National's deferred tax assets in December 2017.

Shortly after the enactment date, the SEC issued SAB 118, which addresses the situations where the accounting for changes in tax laws is complete, incomplete but can be reasonably estimated, and incomplete and cannot be reasonably estimated. SAB 118 also permits a measurement period of up to one year from the date of enactment to refine the provisional accounting. During the six months ended June 30, 2018, immaterial adjustments made to the preliminary valuation of assets acquired and liabilities assumed in the acquisition of Anchor (MN) impacted the estimated revaluation of Old National's deferred tax assets. Old National completed its analysis of H.R. 1 during the second quarter of 2018.

Unrecognized Tax Benefits

Old National and its subsidiaries file a consolidated U.S. federal income tax return, as well as filing various state returns. Unrecognized state income tax benefits are reported net of their related deferred federal income tax benefit.

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A reconciliation of the beginning and ending amounts of unrecognized tax benefits was as follows:

(dollars in thousands)	Six Months Ended	
	June 30,	
	2018	2017
Balance at beginning of period	\$ 874	\$ 777
Additions based on tax positions related to the current year		70
Balance at end of period	\$ 874	\$ 847

If recognized, approximately \$0.9 million of unrecognized tax benefits, net of interest, would favorably affect the effective income tax rate in future periods. Old National expects the total amount of unrecognized tax benefits to decrease by approximately \$0.3 million in the next twelve months.

Net Deferred Tax Assets

Significant components of net deferred tax assets (liabilities) were as follows at June 30, 2018 and December 31, 2017:

(dollars in thousands)	June 30,	December 31,
	2018	2017
Deferred Tax Assets		
Allowance for loan losses, net of recapture	\$ 13,842	\$ 12,958
Benefit plan accruals	12,146	11,080
Alternative minimum tax credit	2,545	25,084
Unrealized losses on benefit plans	94	108
Net operating loss carryforwards	32,915	39,631
Federal tax credits	12,050	5,516
Other-than-temporary impairment	36	1,424
Deferred gain on securities	2,052	
Acquired loans	23,976	29,669
Lease exit obligation	1,290	1,337
Unrealized losses on available-for-sale investment securities	18,733	14,011
Unrealized losses on held-to-maturity investment securities	2,746	3,630
Unrealized losses on hedges		923
Tax credit investments	862	
Other real estate owned	181	369
Other, net	2,405	829
Total deferred tax assets	125,873	146,569
Deferred Tax Liabilities		

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Accretion on investment securities	(451)	(493)
Purchase accounting	(15,972)	(16,718)
Loan servicing rights	(5,970)	(6,058)
Premises and equipment	(9,512)	(10,052)
Prepaid expenses	(1,277)	(1,277)
Tax credit investments		(168)
Unrealized gains on hedges	(742)	
Other, net	(1,762)	(946)
Total deferred tax liabilities	(35,686)	(35,712)
Net deferred tax assets	\$ 90,187	\$ 110,857

Through the acquisition of Anchor (WI) in the second quarter of 2016 and Lafayette Savings Bank in the fourth quarter of 2014, both former thrifts, Old National Bank's retained earnings at June 30, 2018 include base-year bad debt reserves, created for tax purposes prior to 1988, totaling \$52.8 million. Of this total, \$50.9 million was

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acquired from Anchor (WI), and \$1.9 million was acquired from Lafayette Savings Bank. Base-year reserves are subject to recapture in the unlikely event that Old National Bank (1) makes distributions in excess of current and accumulated earnings and profits, as calculated for federal income tax purposes, (2) redeems its stock, or (3) liquidates. Old National Bank has no intention of making such a nondividend distribution. Accordingly, under current accounting principles, a related deferred income tax liability of \$13.0 million has not been recognized.

No valuation allowance was recorded at June 30, 2018 or December 31, 2017 because, based on current expectations, Old National believes it will generate sufficient income in future years to realize deferred tax assets. Old National has federal net operating loss carryforwards totaling \$104.5 million at June 30, 2018 and \$130.7 million at December 31, 2017. This federal net operating loss was acquired from the acquisition of Anchor (WI) in 2016. If not used, the federal net operating loss carryforwards will expire from 2028 to 2033. Old National has alternative minimum tax (AMT) credit carryforwards totaling \$22.6 million at June 30, 2018 and \$25.1 million at December 31, 2017. The enactment of H.R. 1 eliminates the parallel tax system known as the AMT and allows any existing AMT credits to be used to reduce regular tax or be refunded from 2018 to 2021. ASC 740 allows for the reclassification of the AMT credit from a deferred tax asset to a current tax asset, except for the amount limited by section 382. Old National has \$2.5 million of AMT credit carryforward subject to section 382 limitations. The \$2.5 million is maintained in deferred tax assets and the remaining \$20.1 million has been reclassified to a current tax asset. Old National has federal tax credit carryforwards of \$12.1 million at June 30, 2018 and \$5.5 million at December 31, 2017. The federal tax credits consist mainly of federal historic credits, energy efficient home credits, low income housing credits, and research and development credits that, if not used, will expire from 2025 to 2038. Old National has recorded state net operating loss carryforwards totaling \$183.4 million at June 30, 2018 and \$203.6 million at December 31, 2017. If not used, the state net operating loss carryforwards will expire from 2024 to 2033. Old National has state tax credit carryforwards totaling \$0.7 million at June 30, 2018 and \$1.3 million at December 31, 2017. The state tax credits will not expire.

The federal and recorded state net operating loss carryforwards are subject to an annual limitation under Internal Revenue Code section 382. Old National believes that all of the recorded net operating loss carryforwards will be used prior to expiration.

NOTE 21 DERIVATIVE FINANCIAL INSTRUMENTS

As discussed in Note 3, Old National adopted ASU 2017-12 in the first quarter of 2018. This adoption primarily impacted our existing cash flow and fair value hedges related to certain FHLB advances. For cash flow hedges as of the date of adoption, the transition guidance in paragraph 815-20-65-3(d) eliminated the separate measurement of ineffectiveness by means of a cumulative-effect adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings. For fair value hedges of interest rate risk, the provisions of paragraph 815-25-35-13 permit Old National to elect to modify the measurement methodology to be based on the benchmark rate component of the contractual coupon cash flows without dedesignation of the hedging relationship. The measurement methodology modification shall be applied as of the hedging relationship's original inception date. The cumulative effect of applying this election shall be recognized as an adjustment to the basis adjustment of the hedged item recognized on the balance sheet with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.

As part of our overall interest rate risk management, Old National uses derivative instruments, including interest rate swaps, caps, and floors. The notional amount of these derivative instruments was \$1.034 billion at June 30, 2018 and \$708.5 million at December 31, 2017. These derivative financial instruments at June 30, 2018 consisted of \$408.5 million notional amount of receive-fixed, pay-variable interest rate swaps on certain of its FHLB advances and \$625.0 million notional amount of pay-fixed, receive-variable interest rate swaps on certain of its FHLB advances. Derivative financial instruments at December 31, 2017 consisted of \$33.5 million notional amount of receive-fixed,

pay-variable interest rate swaps on certain of its FHLB advances and \$675.0 million notional amount of pay-fixed, receive-variable interest rate swaps on certain of its FHLB advances. These hedges were entered into to manage interest rate risk. Derivative instruments are recognized on the balance sheet at their fair value and are not reported on a net basis.

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In accordance with ASC 815-20-35-1, subsequent changes in fair value for a hedging instrument that has been designated and qualifies as part of a hedging relationship should be accounted for in the following manner:

Cash flow hedges: changes in fair value will be recognized as a component in other comprehensive income.

Fair value hedges: changes in fair value will be recognized concurrently in earnings.

Consistent with this guidance, as long as a hedging instrument is designated and the results of the effectiveness testing support that the instrument qualifies for hedge accounting treatment, 100% of the periodic changes in fair value of the hedging instrument will be accounted for as outlined above. This is the case whether or not economic mismatches exist in the hedging relationship. As a result, there will be no periodic measurement or recognition of ineffectiveness. Rather, the full impact of hedge gains and losses will be recognized in the period in which the hedged transactions impact earnings.

While separate measurement and presentation of ineffectiveness is being eliminated, paragraph 815-20-45-1A requires the change in fair value of the hedging instrument that is included in the assessment of hedge effectiveness be presented in the same income statement line item that is used to present the earnings effect of the hedged item.

Commitments to fund certain mortgage loans (interest rate lock commitments) and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. These derivative contracts do not qualify for hedge accounting. At June 30, 2018, the notional amount of the interest rate lock commitments was \$59.3 million and forward commitments were \$76.1 million. At December 31, 2017, the notional amount of the interest rate lock commitments was \$29.9 million and forward commitments were \$41.2 million. It is our practice to enter into forward commitments for the future delivery of residential mortgage loans to third party investors when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from our commitment to fund the loans.

Old National also enters into derivative instruments for the benefit of its customers. The notional amounts of these customer derivative instruments and the offsetting counterparty derivative instruments were \$827.6 million at June 30, 2018. The notional amounts of these customer derivative instruments and the offsetting counterparty derivative instruments were \$826.6 million at December 31, 2017. These derivative contracts do not qualify for hedge accounting. These instruments include interest rate swaps, caps, and collars. Commonly, Old National will economically hedge significant exposures related to these derivative contracts entered into for the benefit of customers by entering into offsetting contracts with approved, reputable, independent counterparties with substantially matching terms.

Old National enters into derivative financial instruments as part of its foreign currency risk management strategies. These derivative instruments consist of foreign currency forward contracts to accommodate the business needs of its customers. Old National does not designate these foreign currency forward contracts for hedge accounting treatment. The notional amounts of these foreign currency forward contracts and the offsetting counterparty derivative instruments were \$2.1 million at June 30, 2018 and \$0.8 million at December 31, 2017.

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. Old National's exposure is limited to the replacement value of the contracts rather than the notional, principal, or contract amounts. There are provisions in our agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, we minimize credit risk through credit approvals, limits, and monitoring procedures.

Amounts reported in AOCI related to cash flow hedges will be reclassified to interest income or interest expense as interest payments are received or paid on Old National's derivative instruments. During the next 12 months, we estimate that \$2.0 million will be reclassified to interest income and \$0.8 million will be reclassified to interest expense.

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The following table summarizes the fair value of derivative financial instruments utilized by Old National:

(dollars in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
June 30, 2018				
Derivatives designated as hedging instruments				
Interest rate contracts	Other assets	\$ 4,871	Other liabilities	\$ 1,656
Total derivatives designated as hedging instruments		\$ 4,871		\$ 1,656
Derivatives not designated as hedging instruments				
Interest rate contracts	Other assets	\$ 8,524	Other liabilities	\$ 19,148
Mortgage contracts	Other assets	1,537	Other liabilities	352
Foreign currency contracts	Other assets	61	Other liabilities	40
Total derivatives not designated as hedging instruments		\$ 10,122		\$ 19,540
Total		\$ 14,993		\$ 21,196
December 31, 2017				
Derivatives designated as hedging instruments				
Interest rate contracts	Other assets	\$ 3,351	Other liabilities	\$ 5,351
Total derivatives designated as hedging instruments		\$ 3,351		\$ 5,351
Derivatives not designated as hedging instruments				
Interest rate contracts	Other assets	\$ 10,012	Other liabilities	\$ 10,933
Mortgage contracts	Other assets	747	Other liabilities	
Foreign currency contracts	Other assets	8	Other liabilities	8
Total derivatives not designated as hedging instruments		\$ 10,767		\$ 10,941
Total		\$ 14,118		\$ 16,292

The effect of derivative instruments in fair value hedging relationships on the consolidated statements of income for the three and six months ended June 30, 2018 and 2017 were as follows:

(dollars in thousands)

Derivatives in Fair Value Hedging Relationships	Location of Gain or (Loss) Recognized in			Gain (Loss) Recognized in Income on Related Hedged Items
	in Income on Derivative	Gain (Loss) Recognized in Income on Derivative	Hedged Items in Fair Value Hedging Relationships	
Three Months Ended June 30, 2018				
Interest rate contracts	Interest income/(expense)	\$ (944)	Fixed-rate debt	Interest income/(expense) \$ 934
Three Months Ended June 30, 2017				
Interest rate contracts	Interest income/(expense)	\$ 77	Fixed-rate debt	Interest income/(expense) \$ (25)
Six Months Ended June 30, 2018				
Interest rate contracts	Interest income/(expense)	\$ (1,663)	Fixed-rate debt	Interest income/(expense) \$ 1,655
Six Months Ended June 30, 2017				
Interest rate contracts	Interest income/(expense)	\$ (178)	Fixed-rate debt	Interest income/(expense) \$ 265

The difference between the gain (loss) recognized in income on derivatives and the gain (loss) recognized in income on the related hedged items represents hedge ineffectiveness. In addition, the net swap settlements that accrue each period are also reported in interest expense.

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The effect of derivative instruments in cash flow hedging relationships on the consolidated statements of income for the three and six months ended June 30, 2018 and 2017 were as follows:

(dollars in thousands)		Three Months Ended June 30,		Three Months Ended June 30,	
		2018	2017	2018	2017
Derivatives in	Location of Gain or	Gain (Loss)		Gain (Loss)	
	(Loss) Reclassified	Recognized in		Reclassified from	
Cash Flow Hedging	from AOCI into Income	Other		AOCI into	
Relationships	(Effective Portion)	Comprehensive		Income (Effective	
		Income on		Portion)	
		Derivative		Portion)	
		(Effective		Portion)	
		Portion)		Portion)	
Interest rate contracts	Interest income/(expense)	\$ 1,516	\$ (2,387)	\$ (10)	\$ (1,734)

(dollars in thousands)		Six Months Ended June 30,		Six Months Ended June 30,	
		2018	2017	2018	2017
Derivatives in	Location of Gain or	Gain (Loss)		Gain (Loss)	
	(Loss) Reclassified	Recognized in		Reclassified from	
Cash Flow Hedging	from AOCI into Income	Other		AOCI into	
Relationships	(Effective Portion)	Comprehensive		Income (Effective	
		Income on		Portion)	
		Derivative		Portion)	
		(Effective		Portion)	
		Portion)		Portion)	
Interest rate contracts	Interest income/(expense)	\$ 6,079	\$ (1,807)	\$ (779)	\$ (3,533)

The ineffective portion and amount excluded from effectiveness testing related to derivatives in cash flow hedging relationships was immaterial for the three and six months ended June 30, 2018 and 2017.

The effect of derivatives not designated as hedging instruments on the consolidated statements of income for the three and six months ended June 30, 2018 and 2017 were as follows:

(dollars in thousands)		Three Months Ended June 30,	
		2018	2017
Derivatives Not Designated as	Location of Gain or (Loss)	Gain (Loss)	
		Recognized in Income on	
Hedging Instruments	Recognized in Income on	Derivative	

		Derivative	
Interest rate contracts (1)	Other income/(expense)	\$ 27	\$ 13
Mortgage contracts	Mortgage banking revenue	(201)	451
Foreign currency contracts	Other income/(expense)	6	
Total		\$ (168)	\$ 464

		Six Months Ended June 30,	
		2018	2017
(dollars in thousands)		Location of Gain or (Loss)	
Derivatives Not Designated as Hedging Instruments	Recognized in Income on Derivative	Gain (Loss) Recognized in Income on Derivative	
Interest rate contracts (1)	Other income/(expense)	\$ 27	\$ 23
Mortgage contracts	Mortgage banking revenue	437	(1,043)
Foreign currency contracts	Other income/(expense)	23	
Total		\$ 487	\$ (1,020)

(1) Includes the valuation differences between the customer and offsetting swaps.

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In the normal course of business, Old National Bancorp and its subsidiaries have been named, from time to time, as defendants in various legal actions. Certain of the actual or threatened legal actions may include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages.

Old National contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, Old National cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, or other relief, if any, might be. Subject to the foregoing, Old National believes, based on current knowledge and after consultation with counsel, that the outcome of such pending matters will not have a material adverse effect on the consolidated financial condition of Old National, although the outcome of such matters could be material to Old National's operating results and cash flows for a particular future period, depending on, among other things, the level of Old National's revenues or income for such period. Old National will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated.

Old National is not currently involved in any material litigation.

Credit-Related Financial Instruments

In the normal course of business, Old National's banking affiliates have entered into various agreements to extend credit, including loan commitments of \$3.218 billion and standby letters of credit of \$85.7 million at June 30, 2018. At June 30, 2018, approximately \$2.986 billion of the loan commitments had fixed rates and \$232.0 million had floating rates, with the floating interest rates ranging from 0.99% to 15%. At December 31, 2017, loan commitments totaled \$3.144 billion and standby letters of credit totaled \$68.7 million. These commitments are not reflected in the consolidated financial statements. The allowance for unfunded loan commitments totaled \$3.2 million at June 30, 2018 and \$3.1 million at December 31, 2017.

Old National had credit extensions with various unaffiliated banks related to letter of credit commitments issued on behalf of Old National's clients totaling \$12.1 million at June 30, 2018 and \$12.4 million at December 31, 2017. Old National provided collateral to the unaffiliated banks to secure credit extensions totaling \$9.2 million at June 30, 2018 and \$11.5 million at December 31, 2017. Old National did not provide collateral for the remaining credit extensions.

NOTE 23 FINANCIAL GUARANTEES

Old National holds instruments, in the normal course of business with clients, that are considered financial guarantees in accordance with FASB ASC 460-10 (FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*), which requires Old National to record the instruments at fair value. Standby letters of credit guarantees are issued in connection with agreements made by clients to counterparties. Standby letters of credit are contingent upon failure of the client to perform the terms of the underlying contract. Credit risk associated with standby letters of credit is essentially the same as that associated with extending loans to clients and is subject to normal credit policies. The term of these standby letters of credit is typically one year or less. At June 30, 2018, the notional amount of standby letters of credit was \$85.7 million, which represented the maximum amount of future funding requirements, and the carrying value was \$0.4 million. At

December 31, 2017, the notional amount of standby letters of credit was \$68.7 million, which represented the maximum amount of future funding requirements, and the carrying value was \$0.4 million.

Old National is a party in risk participation transactions of interest rate swaps, which had total notional amount of \$30.8 million at June 30, 2018.

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Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Old National Bank, Old National's bank subsidiary, is the only significant subsidiary upon which management makes decisions regarding how to allocate resources and assess performance. Each of the branches of Old National Bank provide a group of similar community banking services, including such products and services as commercial, real estate and consumer loans, time deposits, checking and savings accounts, cash management, brokerage, trust, and investment advisory services. The individual bank branches located throughout our Midwest footprint have similar operating and economic characteristics. While the chief decision maker monitors the revenue streams of the various products, services, and regional locations, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the community banking services and branch locations are considered by management to be aggregated into one reportable operating segment, community banking.

NOTE 25 FAIR VALUE

FASB ASC 820-10 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820-10 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

Level 1 Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Old National used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using swap and LIBOR curves plus spreads that adjust for loss severities, volatility, credit risk, and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

Residential loans held for sale: The fair value of loans held for sale is determined using quoted prices for a similar asset, adjusted for specific attributes of that loan (Level 2).

Derivative financial instruments: The fair values of derivative financial instruments are based on derivative valuation models using market data inputs as of the valuation date (Level 2).

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Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which we have elected the fair value option, are summarized below:

(dollars in thousands)	Fair Value Measurements at June 30, 2018 Using			
	Carrying Value	Quoted Prices in Active Markets for Significant Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Trading securities	\$ 5,596	\$ 5,596	\$	\$
Investment securities available-for-sale:				
U.S. Treasury	5,257	5,257		
U.S. government-sponsored entities and agencies	568,231		568,231	
Mortgage-backed securities - Agency	1,448,526		1,448,526	
States and political subdivisions	797,533		793,505	4,028
Pooled trust preferred securities	8,205			8,205
Other securities	353,913	30,259	323,654	
Residential loans held for sale	26,198		26,198	
Derivative assets	14,993		14,993	
Financial Liabilities				
Derivative liabilities	21,196		21,196	

(dollars in thousands)	Fair Value Measurements at December 31, 2017 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Trading securities	\$ 5,584	\$ 5,584	\$	\$
Investment securities available-for-sale:				
U.S. Treasury	5,551	5,551		
U.S. government-sponsored entities and agencies	664,286		664,286	
Mortgage-backed securities - Agency	1,667,682		1,667,682	
States and political subdivisions	530,193		530,193	

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Pooled trust preferred securities	8,448		8,448
Other securities	320,047	30,965	289,082
Residential loans held for sale	17,930		17,930
Derivative assets	14,118		14,118
Financial Liabilities			
Derivative liabilities	16,292		16,292

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The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

(dollars in thousands)	Pooled Trust Preferred Securities	States and Political Subdivisions
Six Months Ended June 30, 2018		
Balance at beginning of period	\$ 8,448	\$
Accretion (amortization) of discount	10	(18)
Sales/payments received	(305)	
Increase (decrease) in fair value of securities	52	(15)
Transfers into Level 3		4,061
Balance at end of period	\$ 8,205	\$ 4,028
Six Months Ended June 30, 2017		
Balance at beginning of period	\$ 8,119	\$
Accretion of discount	8	
Sales/payments received	(212)	
Increase (decrease) in fair value of securities	182	
Balance at end of period	\$ 8,097	\$

The accretion or amortization of discounts on securities in the table above is included in interest income. An increase in fair value is reflected in the balance sheet as an increase in the fair value of investment securities available-for-sale, an increase in accumulated other comprehensive income, which is included in shareholders' equity, and a decrease in other assets related to the tax impact. A decrease in fair value is reflected in the balance sheet as a decrease in the fair value of investment securities available-for-sale, a decrease in accumulated other comprehensive income, which is included in shareholders' equity, and an increase in other assets related to the tax impact. Old National transferred a \$4.1 million state and political subdivisions security to Level 3 during the six months ended June 30, 2018 because Old National could no longer obtain evidence of observable inputs.

The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy:

(dollars in thousands)	Fair Value	Valuation Techniques	Unobservable Input	Range (Weighted Average)
June 30, 2018				
Pooled trust preferred securities	\$ 8,205	Discounted cash flow	Constant prepayment rate (a)	0.00%
			Additional asset defaults (b)	3.4% - 4.4% (4.1%)
			Expected asset recoveries (c)	0.00%
State and political subdivisions	4,028	Discounted cash flow	No observable inputs	N/A

Local municipality issuance
 Old National owns 100%
 Carried at par

December 31, 2017

Pooled trust preferred securities	\$ 8,448	Discounted cash flow	Constant prepayment rate (a)	0.00%
			Additional asset defaults (b)	4.2% - 9.6% (7.5%)
			Expected asset recoveries (c)	0.0% - 4.1% (0.6%)

- (a) Assuming no prepayments.
- (b) Each currently performing pool asset is assigned a default probability based on the banking environment, which is adjusted for specific issuer evaluation, of 0%, 50%, or 100%.
- (c) Each currently defaulted pool asset is assigned a recovery probability based on specific issuer evaluation of 0%, 25%, or 100%.

Significant changes in any of the unobservable inputs used in the fair value measurement in isolation would result in a significant change to the fair value measurement. The pooled trust preferred securities Old National owns are subordinate note classes that rely on an ongoing cash flow stream to support their values. The senior note classes

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receive the benefit of prepayments to the detriment of subordinate note classes since the ongoing interest cash flow stream is reduced by the early redemption. Generally, a change in prepayment rates or additional pool asset defaults has an impact that is directionally opposite from a change in the expected recovery of a defaulted pool asset.

Assets measured at fair value on a non-recurring basis at June 30, 2018 are summarized below:

	Fair Value Measurements at June 30, 2018 Using Quoted Prices in Active Markets for Significant			
	Carrying Value	Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(dollars in thousands)				
Collateral Dependent Impaired Loans:				
Commercial loans	\$ 4,000	\$	\$	\$ 4,000
Commercial real estate loans	20,375			20,375
Foreclosed Assets:				
Commercial real estate	762			762
Loan servicing rights	158		158	

Impaired commercial and commercial real estate loans that are deemed collateral dependent are valued based on the fair value of the underlying collateral. These estimates are based on the most recently available appraisals with certain adjustments made based on the type of property, age of appraisal, current status of the property, and other related factors to estimate the current value of the collateral. These impaired commercial and commercial real estate loans had a principal amount of \$37.1 million, with a valuation allowance of \$12.7 million at June 30, 2018. Old National recorded provision expense associated with these loans totaling \$4.9 million for the three months ended June 30, 2018 and \$6.5 million for the six months ended June 30, 2018. Old National recorded provision expense associated with impaired commercial and commercial real estate loans that were deemed collateral dependent totaling \$5.1 million for the three months ended June 30, 2017 and \$6.2 million for the six months ended June 30, 2017.

Other real estate owned and other repossessed property is measured at fair value less costs to sell and had a net carrying amount of \$0.8 million at June 30, 2018. The estimates of fair value are based on the most recently available appraisals with certain adjustments made based on the type of property, age of appraisal, current status of the property, and other related factors to estimate the current value of the collateral. There were write-downs of other real estate owned of \$0.1 million for the three months ended June 30, 2018 and \$0.4 million for the six months ended June 30, 2018. There were write-downs of other real estate owned of \$0.8 million for the three months ended June 30, 2017 and \$1.6 million for the six months ended June 30, 2017.

Loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. If the carrying amount of an individual tranche exceeds fair value, impairment is recorded on that tranche so that the servicing asset is carried at fair value. Fair value is determined at a tranche level, based on market prices for comparable mortgage servicing contracts when available, or alternatively based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model utilizes a discount rate, weighted average prepayment speed, and other economic factors that market participants would use in estimating future net servicing income and that can be validated against available market data (Level 2). The valuation allowance for loan servicing rights with impairments at June 30, 2018 totaled \$15 thousand. Old National recorded recoveries associated with these loan servicing rights totaling \$4 thousand for the three months ended June 30, 2018 and \$14 thousand for

the six months ended June 30, 2018. There were impairments of loan servicing rights totaling \$25 thousand for the three months ended June 30, 2017 and \$7 thousand for the six months ended June 30, 2017.

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Assets measured at fair value on a non-recurring basis at December 31, 2017 are summarized below:

(dollars in thousands)	Fair Value Measurements at December 31, 2017 Using Quoted Prices in Active Markets for Significant			
	Carrying Value	Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Collateral Dependent Impaired Loans:				
Commercial loans	\$ 2,217	\$	\$	\$ 2,217
Commercial real estate loans	26,319			26,319
Foreclosed Assets:				
Commercial real estate	1,726			1,726
Residential	55			55
Loan servicing rights	2,964		2,964	

At December 31, 2017, impaired commercial and commercial real estate loans had a principal amount of \$38.6 million, with a valuation allowance of \$10.1 million.

Other real estate owned and other repossessed property had a net carrying amount of \$1.8 million at December 31, 2017.

The valuation allowance for loan servicing rights with impairments at December 31, 2017 totaled \$29 thousand.

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The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy:

(dollars in thousands)	Fair Value	Valuation Techniques	Unobservable Input	Range (Weighted Average)
June 30, 2018				
Collateral Dependent Impaired Loans				
Commercial loans	\$ 4,000	Fair value of collateral	Discount for type of property, age of appraisal, and current status	25% - 35% (30%)
Commercial real estate loans	20,375	Fair value of collateral	Discount for type of property, age of appraisal and current status	0% - 20% (10%)
Foreclosed Assets				
Commercial real estate	762	Fair value of collateral	Discount for type of property, age of appraisal, and current status	8% - 41% (21%)
December 31, 2017				
Collateral Dependent Impaired Loans				
Commercial loans	\$ 2,217	Fair value of collateral	Discount for type of property, age of appraisal, and current status	0% - 98% (49%)
Commercial real estate loans	26,319	Fair value of collateral	Discount for type of property, age of appraisal and current status	10% - 78% (32%)
Foreclosed Assets				
Commercial real estate	1,726	Fair value of collateral	Discount for type of property, age of appraisal, and current status	7% - 25% (18%)
Residential (1)	55	Fair value of collateral	Discount for type of property, age of appraisal, and current status	39%

(1) There was only one foreclosed residential asset at December 31, 2017, so no range or weighted average rate is reported.

Financial instruments recorded using fair value option

Under FASB ASC 825-10, we may elect to report most financial instruments and certain other items at fair value on an instrument-by instrument basis with changes in fair value reported in net income. After the initial adoption, the election is made at the acquisition of an eligible financial asset, financial liability or firm commitment or when certain specified reconsideration events occur. The fair value election may not be revoked once an election is made.

We have elected the fair value option for residential loans held for sale. For these loans, interest income is recorded in the consolidated statements of income based on the contractual amount of interest income earned on the financial assets (except any that are on nonaccrual status). None of these loans are 90 days or more past due, nor are any on nonaccrual status. Included in the income statement is interest income for loans held for sale totaling \$40 thousand for the three months ended June 30, 2018 and \$62 thousand for the six months ended June 30, 2018. Included in the income statement is interest income for loans held for sale totaling \$41 thousand for the three months ended June 30, 2017 and \$69 thousand for the six months ended June 30, 2017.

Residential loans held for sale

Old National has elected the fair value option for newly originated conforming fixed-rate and adjustable-rate first mortgage loans held for sale. These loans are intended for sale and are hedged with derivative instruments. Old National has elected the fair value option to mitigate accounting mismatches in cases where hedge accounting is complex and to achieve operational simplification. The fair value option was not elected for loans held for investment.

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The difference between the aggregate fair value and the aggregate remaining principal balance for loans for which the fair value option has been elected at June 30, 2018 and December 31, 2017 was as follows:

(dollars in thousands)	Aggregate Fair Value	Difference	Contractual Principal
June 30, 2018			
Residential loans held for sale	\$ 26,198	\$ 967	\$ 25,231
December 31, 2017			
Residential loans held for sale	\$ 17,930	\$ 546	\$ 17,384

Accrued interest at period end is included in the fair value of the instruments.

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets carried at fair value:

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest (Expense)	Total Changes in Fair Values Included in Current Period Earnings
Three Months Ended June 30, 2018				
Residential loans held for sale	\$ 387	\$ 3	\$	\$ 390
Three Months Ended June 30, 2017				
Residential loans held for sale	\$ 279	\$ 1	\$	\$ 280
Six Months Ended June 30, 2018				
Residential loans held for sale	\$ 422	\$ 3	\$ (4)	\$ 421
Six Months Ended June 30, 2017				
Residential loans held for sale	\$ 697	\$ 2	\$	\$ 699

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The carrying amounts and estimated fair values of financial instruments not carried at fair value on the balance sheet at June 30, 2018 and December 31, 2017 were as follows:

	Fair Value Measurements at June 30, 2018			
	Carrying Value	Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(dollars in thousands)				
Financial Assets				
Cash, due from banks, money market, and other interest-earning investments	\$ 273,874	\$ 273,874	\$	\$
Investment securities held-to-maturity:				
U.S. government-sponsored entities and agencies	73,570		71,284	
Mortgage-backed securities - Agency	139,594		135,784	
State and political subdivisions	312,554		317,529	
FHLB/Federal Reserve Bank stock	136,206	N/A	N/A	N/A
Loans, net:				
Commercial	2,941,508			2,845,502
Commercial real estate	4,429,274			4,330,899
Residential real estate	2,152,106			2,117,999
Consumer credit	1,719,081			1,669,906
Accrued interest receivable	81,290	13	23,122	58,155
Financial Liabilities				
Deposits:				
Noninterest-bearing demand deposits	\$ 3,600,793	\$ 3,600,793	\$	\$
Checking, NOW, savings, and money market interest-bearing deposits	7,171,033	7,171,033		
Time deposits	1,824,550		1,822,203	
Federal funds purchased and interbank borrowings	175,044	175,044		
Securities sold under agreements to repurchase	347,511	347,511		
FHLB advances	1,757,308			1,747,022
Other borrowings	250,241		249,150	
Accrued interest payable	7,510		7,510	
Standby letters of credit	397			397
Off-Balance Sheet Financial Instruments				
Commitments to extend credit	\$	\$	\$	\$ 3,847

N/A = not applicable

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(dollars in thousands)	Fair Value Measurements at December 31, 2017 Using Quoted Prices in			
	Carrying Value	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Cash, due from banks, money market, and other interest-earning investments	\$ 290,432	\$ 290,432	\$	\$
Investment securities held-to-maturity:				
Mortgage-backed securities - Agency	6,903		7,056	
State and political subdivisions	677,160		720,647	
FHLB/Federal Reserve Bank stock	119,686	N/A	N/A	N/A
Loans, net:				
Commercial	2,698,023			2,707,385
Commercial real estate	4,333,116			4,347,949
Residential real estate	2,165,290			2,210,951
Consumer credit	1,871,311			1,998,194
Accrued interest receivable	87,102	16	24,001	63,085
Financial Liabilities				
Deposits:				
Noninterest-bearing demand deposits	\$ 3,680,807	\$ 3,680,807	\$	\$
Checking, NOW, savings, and money market interest-bearing deposits	7,290,521	7,290,521		
Time deposits	1,634,436		1,620,685	
Federal funds purchased and interbank borrowings	335,033	335,033		
Securities sold under agreements to repurchase	384,810	359,810	25,133	
FHLB advances	1,609,579			1,607,189
Other borrowings	248,782		250,443	
Accrued interest payable	7,029		7,029	
Standby letters of credit	351			351
Off-Balance Sheet Financial Instruments				
Commitments to extend credit	\$	\$	\$	\$ 2,449

N/A = not applicable

The methods utilized to estimate the fair value of financial instruments at December 31, 2017 did not necessarily represent an exit price. In accordance with our adoption of ASU 2016-01 in 2018, the methods utilized to measure the fair value of financial instruments at June 30, 2018 represent an approximation of exit price, however, an actual exit price may differ.

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

The following discussion is an analysis of our results of operations for the three and six months ended June 30, 2018 and 2017, and financial condition as of June 30, 2018, compared to June 30, 2017 and December 31, 2017. This discussion and analysis should be read in conjunction with the consolidated financial statements and related notes. This discussion contains forward-looking statements concerning our business that are based on estimates and involves certain risks and uncertainties. Therefore, future results could differ significantly from our current expectations and the related forward-looking statements.

Table of Contents**FINANCIAL HIGHLIGHTS**

The following table sets forth certain financial highlights of Old National:

(dollars and shares in thousands, except per share data)	Three Months Ended			Six Months Ended	
	June 30, 2018	March 31, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Income Statement:					
Net interest income	\$ 131,963	\$ 128,572	\$ 104,333	\$ 260,535	\$ 210,134
Taxable equivalent adjustment (1)	2,825	2,767	5,643	5,592	11,331
Provision for loan losses	2,446	380	1,355	2,826	1,702
Noninterest income (2)	49,289	41,905	49,271	91,194	92,191
Noninterest expense (2)	130,460	117,157	102,811	247,617	204,702
Net income	44,001	47,983	38,854	91,984	74,846
Common Share Data:					
Weighted average diluted shares	152,568	152,370	135,697	152,483	135,641
Net income (diluted)	\$ 0.29	\$ 0.31	\$ 0.28	\$ 0.60	\$ 0.55
Cash dividends	0.13	0.13	0.13	0.26	0.26
Common dividend payout ratio (3)	45%	41%	46%	43%	47%
Book value	\$ 14.44	\$ 14.32	\$ 13.92	\$ 14.44	\$ 13.92
Stock price	18.60	16.90	17.25	18.60	17.25
Tangible common book value (4)	8.70	8.55	8.85	8.70	8.85
Performance Ratios:					
Return on average assets	1.01%	1.10%	1.05%	1.06%	1.01%
Return on average common equity	8.06	8.86	8.33	8.46	8.11
Return on tangible common equity (4)	14.09	15.62	13.56	14.71	13.11
Return on average tangible common equity (4)	14.28	15.80	13.82	15.04	13.60
Net interest margin (4)	3.55	3.45	3.42	3.50	3.46
Efficiency ratio (2)(4)	69.58	65.84	64.05	67.76	64.35
Net charge-offs (recoveries) to average loans	(0.03)	0.01	0.01	(0.01)	0.01
Allowance for loan losses to ending loans	0.48	0.45	0.55	0.48	0.55
Non-performing loans to ending loans	1.38	1.28	1.51	1.38	1.51
Balance Sheet:					
Total loans	\$ 11,295,629	\$ 11,238,682	\$ 9,232,040	\$ 11,295,629	\$ 9,232,040
Total assets	17,482,990	17,496,287	14,957,281	17,482,990	14,957,281
Total deposits	12,596,376	12,788,600	10,683,714	12,596,376	10,683,714
Total borrowed funds	2,530,104	2,371,292	2,259,918	2,530,104	2,259,918

Total shareholders equity	2,200,215	2,179,118	1,886,594	2,200,215	1,886,594
Nonfinancial Data:					
Full-time equivalent employees	2,683	2,721	2,652	2,683	2,652
Banking centers	183	191	188	183	188

- (1) Calculated using the federal statutory tax rate in effect of 21% for the three and six months ended June 30, 2018 and three months ended March 31, 2018 and 35% for the three and six months ended June 30, 2017.
- (2) For the three months ended March 31, 2018, amounts reflect the reclassification of \$0.5 million of agency costs from data processing expense to investment product fees revenue as a result of the implementation of the revenue recognition accounting standard.
- (3) Cash dividends per share divided by net income per share (basic).
- (4) Represents a non-GAAP financial measure. Refer to the Non-GAAP Financial Measures section for reconciliations to GAAP financial measures.

Table of Contents**NON-GAAP FINANCIAL MEASURES**

Non-GAAP financial measures exclude certain items that are included in the financial results presented in accordance with GAAP. Management believes these non-GAAP financial measures enhance an investor's understanding of the financial results of Old National by providing a meaningful basis for period-to-period comparisons, assisting in operating results analysis, and predicting future performance.

The following table presents GAAP to non-GAAP reconciliations.

(dollars and shares in thousands, except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Tangible common book value:				
Shareholders' equity (GAAP)	\$ 2,200,215	\$ 1,886,594	\$ 2,200,215	\$ 1,886,594
Deduct: Goodwill	828,804	655,018	828,804	655,018
Intangible assets	45,417	31,876	45,417	31,876
Tangible shareholders' equity (non-GAAP)	\$ 1,325,994	\$ 1,199,700	\$ 1,325,994	\$ 1,199,700
Period end common shares	152,351	135,516	152,351	135,516
Tangible common book value	8.70	8.85	8.70	8.85
Return on tangible common equity:				
Net income (GAAP)	\$ 44,001	\$ 38,854	\$ 91,984	\$ 74,846
Add: Intangible amortization (net of tax)	2,699	1,807	5,550	3,770
Tangible net income (non-GAAP)	\$ 46,700	\$ 40,661	\$ 97,534	\$ 78,616
Tangible shareholders' equity (non-GAAP) (see above)	\$ 1,325,994	\$ 1,199,700	\$ 1,325,994	\$ 1,199,700
Return on tangible common equity	14.09%	13.56%	14.71%	13.11%
Return on average tangible common equity:				
Tangible net income (non-GAAP) (see above)	\$ 46,700	\$ 40,661	\$ 97,534	\$ 78,616
Average shareholders' equity (GAAP)	\$ 2,183,604	\$ 1,865,318	\$ 2,174,878	\$ 1,845,598
Deduct: Average goodwill	828,804	655,018	828,474	655,018
Average intangible assets	47,052	33,189	49,061	34,635
Average tangible shareholders' equity (non-GAAP)	\$ 1,307,748	\$ 1,177,111	\$ 1,297,343	\$ 1,155,945

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Return on average tangible common equity	14.28%	13.82%	15.04%	13.60%
Net interest margin:				
Net interest income (GAAP)	\$ 131,963	\$ 104,333	\$ 260,535	\$ 210,134
Taxable equivalent adjustment	2,825	5,643	5,592	11,331
Net interest income - taxable equivalent basis (non-GAAP)	\$ 134,788	\$ 109,976	\$ 266,127	\$ 221,465
Average earning assets	\$ 15,176,711	\$ 12,844,504	\$ 15,191,220	\$ 12,793,962
Net interest margin	3.55%	3.42%	3.50%	3.46%
Efficiency ratio:				
Noninterest expense (GAAP)	\$ 130,460	\$ 102,811	\$ 247,617	\$ 204,702
Deduct: Intangible amortization expense	3,416	2,781	7,025	5,801
Adjusted noninterest expense (non-GAAP)	\$ 127,044	\$ 100,030	\$ 240,592	\$ 198,901
Net interest income - taxable equivalent basis (non-GAAP) (see above)	\$ 134,788	\$ 109,976	\$ 266,127	\$ 221,465
Noninterest income	49,289	49,271	91,194	92,191
Deduct: Net securities gains (losses)	1,494	3,075	2,282	4,575
Adjusted total revenue (non-GAAP)	\$ 182,583	\$ 156,172	\$ 355,039	\$ 309,081
Efficiency ratio	69.58%	64.05%	67.76%	64.35%

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Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. Although these non-GAAP financial measures are frequently used by investors to evaluate a company, they have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP. These non-GAAP measures are not necessarily comparable to similar measures that may be represented by other companies.

EXECUTIVE SUMMARY

During the second quarter of 2018, net income was \$44.0 million, or \$0.29 per diluted share. Net income was \$38.9 million, or \$0.28 per diluted share, for the second quarter of 2017.

Management's strategy is basic banking—loan growth, fee income, and expense management. Simply put, our low-cost core deposits fuel our commercial loan growth. That loan growth is filtered through our staunch credit process. Underpinning all that we do is management's focus on controlling costs. Management is committed to driving and sustaining positive operating leverage.

We continue to benefit from re-mixing our earning assets by replacing lower yielding assets, like indirect auto loans, with higher yielding assets, like commercial loans.

Loan Growth: Our loan balances, excluding loans held for sale, grew \$56.9 million to \$11.296 billion at June 30, 2018 compared to \$11.239 billion at March 31, 2018. Commercial and industrial loans continue to be the driver of our loan growth. This is attributable to our focus on our growth markets as well as our earning asset re-mix strategy. Commercial loan growth was partially offset by the sale of the student loan portfolio totaling \$64.9 million during the second quarter of 2018.

Net Interest Income: For the six months ended June 30, 2018, compared to the six months ended June 30, 2017 our net interest income increased primarily due to volume from the Anchor (MN) acquisition in November 2017 and increased loan yields. This was further augmented by our low cost of deposits over the same period. The second quarter of 2018 compared to the first quarter of 2018 increased similarly with increased commercial and industrial loan volume outpacing a slight increase in deposit and borrowing costs.

Fee Income: Fee income decreased slightly to \$91.2 million from \$92.2 million for the six months ended June 30, 2018 when compared to the six months ended June 30, 2017 due to lower capital markets income and lower securities gains, partially offset by the volume increases due to the acquisition of Anchor (MN) in November 2017. For the second quarter of 2018 compared to the first quarter of 2018, our fee income increased to \$49.3 million from \$41.9 million, substantially due to a few larger items in other income and seasonality in wealth management fee income and mortgage banking revenue.

Expenses: Noninterest expenses increased \$42.9 million, or 21%, for the six months ended June 30, 2018 when compared to the six months ended June 30, 2017. The increase was primarily attributable to higher expenses associated with the Anchor (MN) partnership. Also contributing to the increase in noninterest expense was amortization of tax credit investments totaling \$12.6 million for the six months ended June 30, 2018 reflecting the completion of investment tax credit projects during 2018. As previously disclosed, we have consolidated 157 branches since the beginning of 2011 and have entered into a branch purchase and assumption agreement for the sale of ten Old National branches in Wisconsin to Marine Credit Union of La Crosse, Wisconsin. The branch sale includes the assumption of approximately \$261 million in deposits and no loans. Subject to regulatory approval and other terms and conditions, the sale is expected to close in the fourth quarter of 2018. For the remainder of 2018, we are evaluating the Old National franchise for additional consolidation opportunities.

We remain an active looker and a selective, disciplined buyer in demographically accretive markets when it comes to future partnerships. We believe our ability to bring an enhanced product set and a larger balance sheet with better capital allows a potential partner to better serve their clients. As previously disclosed, we do not feel compelled to enter into a partnership.

Table of Contents**RESULTS OF OPERATIONS**

The following table sets forth certain income statement information of Old National for the three and six months ended June 30, 2018 and 2017:

(dollars in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2018	2017	% Change	June 30, 2018	2017	% Change
Income Statement Summary:						
Net interest income	\$ 131,963	\$ 104,333	26.5%	\$ 260,535	\$ 210,134	24.0%
Provision for loan losses	2,446	1,355	80.5	2,826	1,702	66.0
Noninterest income	49,289	49,271	0.0	91,194	92,191	(1.1)
Noninterest expense	130,460	102,811	26.9	247,617	204,702	21.0
Other Data:						
Return on average common equity	8.06%	8.33%		8.46%	8.11%	
Return on tangible common equity (1)	14.09	13.56		14.71	13.11	
Return on average tangible common equity (1)	14.28	13.82		15.04	13.60	
Efficiency ratio (1)	69.58	64.05		67.76	64.35	
Tier 1 leverage ratio	8.30	8.65		8.30	8.65	
Net charge-offs (recoveries) to average loans	(0.03)	0.01		(0.01)	0.01	

(1) Represents a non-GAAP financial measure. Refer to Non-GAAP Financial Measures section for reconciliations to GAAP financial measures.

Net Interest Income

Net interest income is the most significant component of our earnings, comprising 74% of revenues for the six months ended June 30, 2018. Net interest income and margin are influenced by many factors, primarily the volume and mix of earning assets, funding sources, and interest rate fluctuations. Other factors include the level of accretion income on purchased loans, prepayment risk on mortgage and investment-related assets, and the composition and maturity of earning assets and interest-bearing liabilities.

The Federal Reserve increased the discount rate 25 basis points at both of their March and June 2018 meetings. The rate increases were driven by the Federal Reserve's inflation and wage pressure expectations in conjunction with a moderately expanding economy. The Treasury yield curve flattened as short-term rates rose while long-term interest rates remained flat. Collectively, these factors marginally improved the outlook for our net interest income and margin.

Loans typically generate more interest income than investment securities with similar maturities. Funding from client deposits generally costs less than wholesale funding sources. Factors such as general economic activity, Federal Reserve monetary policy, and price volatility of competing alternative investments, can also exert significant influence on our ability to optimize the mix of assets and funding and the net interest income and margin.

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Net interest income is the excess of interest received from earning assets over interest paid on interest-bearing liabilities. For analytical purposes, net interest income is also presented in the table that follows, adjusted to a taxable equivalent basis to reflect what our tax-exempt assets would need to yield in order to achieve the same after-tax yield as a taxable asset. We used the federal statutory tax rate in effect of 21% for the three and six months ended June 30, 2018, compared to 35% for the three and six months ended June 30, 2017. This analysis portrays the income tax benefits associated in tax-exempt assets and helps to facilitate a comparison between taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully taxable equivalent basis. Therefore, management believes these measures provide useful information for both management and investors by allowing them to make peer comparisons.

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net interest income	\$ 131,963	\$ 104,333	\$ 260,535	\$ 210,134
Conversion to fully taxable equivalent	2,825	5,643	5,592	11,331
Net interest income - taxable equivalent basis	\$ 134,788	\$ 109,976	\$ 266,127	\$ 221,465
Average earning assets	\$ 15,176,711	\$ 12,844,504	\$ 15,191,220	\$ 12,793,962
Net interest margin	3.48%	3.25%	3.43%	3.28%
Net interest margin - taxable equivalent basis	3.55%	3.42%	3.50%	3.46%

The increase in net interest income for the three and six months ended June 30, 2018 when compared to the same periods in 2017 was primarily due to higher average earning assets of \$2.332 billion in the three months ended June 30, 2018 when compared to the three months ended June 30, 2017 and \$2.397 billion in the six months ended June 30, 2018 when compared to the six months ended June 30, 2017. Partially offsetting the higher average earning assets were higher average interest-bearing liabilities of \$1.612 billion in the three months ended June 30, 2018 when compared to the three months ended June 30, 2017 and \$1.642 billion in the six months ended June 30, 2018 when compared to the six months ended June 30, 2017. Interest income in the three and six months ended June 30, 2018 included lower fully taxable equivalent interest income resulting from the income tax rate decrease to 21% in 2018. Net interest income for the three and six months ended June 30, 2018 and 2017 included accretion income (interest income in excess of contractual interest income) associated with acquired loans. Accretion income totaled \$11.5 million in the three months ended June 30, 2018 and \$22.5 million in the six months June 30, 2018, compared to \$9.7 million in the three months ended June 30, 2017 and \$22.3 million in the six months ended June 30, 2017. We expect accretion income on our PCI loans to decrease over time, but this may be offset by future acquisitions.

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The following tables present the average balance sheet for each major asset and liability category, its related interest income and yield, or its expense and rate for the three and six months ended June 30, 2018 and 2017.

(dollars in thousands)	Three Months Ended June 30, 2018			Three Months Ended June 30, 2017		
	Average Balance	Income (1)/ Expense	Yield/ Rate	Average Balance	Income (1)/ Expense	Yield/ Rate
Earning Assets						
Money market and other interest-earning investments	\$ 51,724	\$ 117	0.91%	\$ 27,222	\$ 55	0.80%
Investment securities:						
Treasury and government sponsored agencies	648,778	3,387	2.09%	575,940	2,798	1.94%
Mortgage-backed securities	1,588,140	8,904	2.24%	1,485,582	7,590	2.04%
States and political subdivisions	1,118,395	10,591	3.79%	1,122,769	13,375	4.76%
Other securities	507,646	3,909	3.08%	446,521	2,866	2.57%
Total investment securities	3,862,959	26,791	2.77%	3,630,812	26,629	2.93%
Loans: (2)						
Commercial	2,873,781	32,527	4.48%	1,938,751	19,352	3.95%
Commercial real estate	4,449,839	57,251	5.09%	3,240,318	39,830	4.86%
Residential real estate loans	2,177,587	22,208	4.08%	2,127,867	21,268	4.00%
Consumer	1,760,821	17,667	4.02%	1,879,534	16,718	3.57%
Total loans	11,262,028	129,653	4.57%	9,186,470	97,168	4.21%
Total earning assets	15,176,711	\$ 156,561	4.11%	12,844,504	\$ 123,852	3.84%
Less: Allowance for loan losses	(51,493)			(50,937)		
Non-earning Assets						
Cash and due from banks	205,617			200,209		
Other assets	2,086,822			1,860,676		
Total assets	\$ 17,417,657			\$ 14,854,452		
Interest-Bearing Liabilities						
Checking and NOW accounts	\$ 3,097,635	\$ 969	0.13%	\$ 2,643,123	\$ 511	0.08%
Savings accounts	3,036,936	1,777	0.23%	2,944,314	1,209	0.16%
Money market accounts	1,103,177	702	0.26%	684,911	146	0.09%
Time deposits	1,810,328	5,691	1.26%	1,441,998	2,858	0.80%
Total interest-bearing deposits	9,048,076	9,139	0.41%	7,714,346	4,724	0.25%
Federal funds purchased and interbank borrowings	140,471	647	1.85%	166,690	422	1.02%

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Securities sold under agreements to repurchase	332,599	434	0.52%	329,182	334	0.41%
FHLB advances	1,713,832	8,824	2.07%	1,443,453	6,017	1.67%
Other borrowings	249,291	2,729	4.38%	219,085	2,379	4.34%
Total borrowed funds	2,436,193	12,634	2.08%	2,158,410	9,152	1.70%
Total interest-bearing liabilities	\$ 11,484,269	\$ 21,773	0.76%	\$ 9,872,756	\$ 13,876	0.56%
Noninterest-Bearing Liabilities						
Demand deposits	\$ 3,602,732			\$ 2,988,147		
Other liabilities	147,052			128,231		
Shareholders' equity	2,183,604			1,865,318		
Total liabilities and shareholders' equity	\$ 17,417,657			\$ 14,854,452		
Net interest rate spread			3.35%			3.28%
Net interest margin (3)			3.55%			3.42%
Taxable equivalent adjustment		\$ 2,825			\$ 5,643	

- (1) Interest income is reflected on a fully taxable equivalent basis.
- (2) Includes loans held for sale.
- (3) Net interest margin is defined as net interest income on a tax equivalent basis as a percentage of average earning assets.

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(dollars in thousands)	Six Months Ended June 30, 2018			Six Months Ended June 30, 2017		
	Average Balance	Income (1)/ Expense	Yield/ Rate	Average Balance	Income (1)/ Expense	Yield/ Rate
Earning Assets						
Money market and other interest-earning investments	\$ 59,089	\$ 207	0.71%	\$ 27,352	\$ 86	0.63%
Investment securities:						
Treasury and government sponsored agencies	655,897	6,811	2.08%	558,279	5,579	2.00%
Mortgage-backed securities	1,610,252	18,424	2.29%	1,498,414	15,408	2.06%
States and political subdivisions	1,161,386	21,069	3.63%	1,128,042	26,981	4.78%
Other securities	483,685	7,578	3.13%	445,881	5,694	2.55%
Total investment securities	3,911,220	53,882	2.76%	3,630,616	53,662	2.96%
Loans: (2)						
Commercial	2,817,050	60,733	4.29%	1,913,480	38,440	4.00%
Commercial real estate	4,422,075	113,037	5.08%	3,205,853	80,154	4.97%
Residential real estate loans	2,177,003	43,680	4.01%	2,134,681	42,522	3.98%
Consumer	1,804,783	35,495	3.97%	1,881,980	33,144	3.55%
Total loans	11,220,911	252,945	4.50%	9,135,994	194,260	4.25%
Total earning assets	15,191,220	\$ 307,034	4.04%	12,793,962	\$ 248,008	3.87%
Less: Allowance for loan losses	(51,225)			(50,824)		
Non-earning Assets						
Cash and due from banks	202,392			197,927		
Other assets	2,088,299			1,869,215		
Total assets	\$ 17,430,686			\$ 14,810,280		
Interest-Bearing Liabilities						
Checking and NOW accounts	\$ 3,082,619	\$ 1,788	0.12%	\$ 2,614,627	\$ 967	0.07%
Savings accounts	3,044,748	3,120	0.21%	2,957,020	2,367	0.16%
Money market accounts	1,130,939	1,248	0.22%	695,890	295	0.09%
Time deposits	1,773,859	10,238	1.16%	1,441,218	5,478	0.77%
Total interest-bearing deposits	9,032,165	16,394	0.37%	7,708,755	9,107	0.24%
Federal funds purchased and interbank borrowings	200,578	1,664	1.67%	177,818	778	0.88%
Securities sold under agreements to repurchase	337,612	793	0.47%	330,285	590	0.36%
FHLB advances	1,694,871	16,604	1.98%	1,436,752	11,329	1.59%
Other borrowings	249,062	5,452	4.38%	219,025	4,739	4.33%

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Total borrowed funds	2,482,123	24,513	1.99%	2,163,880	17,436	1.62%
Total interest-bearing liabilities	\$ 11,514,288	\$ 40,907	0.72%	\$ 9,872,635	\$ 26,543	0.54%
Noninterest-Bearing Liabilities						
Demand deposits	\$ 3,583,027			\$ 2,952,797		
Other liabilities	158,493			139,250		
Shareholders equity	2,174,878			1,845,598		
Total liabilities and shareholders equity	\$ 17,430,686			\$ 14,810,280		
Net interest rate spread			3.32%			3.33%
Net interest margin (3)			3.50%			3.46%
Taxable equivalent adjustment		\$ 5,592			\$ 11,331	

- (1) Interest income is reflected on a fully taxable equivalent basis.
- (2) Includes loans held for sale.
- (3) Net interest margin is defined as net interest income on a tax equivalent basis as a percentage of average earning assets.

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The following table presents the dollar amount of changes in taxable equivalent net interest income attributable to changes in the average balances of assets and liabilities and the yields earned or rates paid for the three and six months ended June 30, 2018 and 2017.

	From Three Months Ended June 30, 2017 to Three Months Ended June 30, 2018			From Six Months Ended June 30, 2017 to Six Months Ended June 30, 2018		
	Total Change	Attributed to Volume	Attributed to Rate	Total Change	Attributed to Volume	Attributed to Rate
(dollars in thousands)						
Interest Income						
Money market and other interest-earning investments	\$ 62	\$ 51	\$ 11	\$ 121	\$ 105	\$ 16
Investment securities (1)	162	1,657	(1,495)	220	4,006	(3,786)
Loans (1)	32,485	22,944	9,541	58,685	45,729	12,956
Total interest income	32,709	24,652	8,057	59,026	49,840	9,186
Interest Expense						
Checking and NOW deposits	458	115	343	821	221	600
Savings deposits	568	45	523	753	77	676
Money market deposits	556	177	379	953	331	622
Time deposits	2,833	942	1,891	4,760	1,585	3,175
Federal funds purchased and interbank borrowings	225	(94)	319	886	141	745
Securities sold under agreements to repurchase	100	4	96	203	14	189
FHLB advances	2,807	1,259	1,548	5,275	2,278	2,997
Other borrowings	350	329	21	713	654	59
Total interest expense	7,897	2,777	5,120	14,364	5,301	9,063
Net interest income	\$ 24,812	\$ 21,875	\$ 2,937	\$ 44,662	\$ 44,539	\$ 123

The variance not solely due to rate or volume is allocated equally between the rate and volume variances.

- (1) Interest on investment securities and loans includes the effect of taxable equivalent adjustments of \$1.1 million and \$1.8 million, respectively, during the three months ended June 30, 2018; and \$2.1 million and \$3.5 million, respectively, during the six months ended June 30, 2018; using the federal statutory rate in effect of 21%.

The increase in the net interest margin on a fully taxable equivalent basis for the three and six months ended June 30, 2018 when compared to the same periods in 2017 was primarily due to higher yield on interest earning assets and a change in the mix of average interest earning assets and interest-bearing liabilities, partially offset by higher costs of interest-bearing liabilities. The yield on interest earning assets increased 27 basis points and the cost of interest-bearing liabilities increased 20 basis points in the quarterly year-over-year comparison. The yield on interest earning assets is calculated by dividing annualized taxable equivalent net interest income by average interest earning assets while the cost of interest-bearing liabilities is calculated by dividing annualized interest expense by average

interest-bearing liabilities. Accretion income represented 30 basis points of the net interest margin for the three months ended June 30, 2018 and 2017. The increase in the net interest margin for the six months ended June 30, 2018 was also partially offset by lower yields associated with accretion income on acquired loans. Accretion income represented 30 basis points of the net interest margin for the six months ended June 30, 2018, compared to 35 basis points of the net interest margin for the six months ended June 30, 2017. The yield on interest earning assets increased 17 basis points and the cost of interest-bearing liabilities increased 18 basis points in the six months ended June 30, 2018 when compared to the six months ended June 30, 2017.

Average earning assets were \$15.177 billion for the three months ended June 30, 2018, compared to \$12.845 billion for the three months ended June 30, 2017, an increase of \$2.332 billion, or 18%. Average earning assets were \$15.191 billion for the six months ended June 30, 2018, compared to \$12.794 billion for the six months ended June 30, 2017, an increase of \$2.397 billion, or 19%. The increases in average earning assets were primarily due to our acquisition of Anchor (MN) in November 2017. The loan portfolio including loans held for sale, which generally has an average yield higher than the investment portfolio, was approximately 74% of average interest earning assets for the six months ended June 30, 2018, compared to 71% for the six months ended June 30, 2017.

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Average loans including loans held for sale increased \$2.076 billion for the three months ended June 30, 2018 and \$2.085 billion for the six months ended June 30, 2018 when compared to the same periods in 2017 reflecting organic loan growth, as well as an increase attributable to loans acquired from Anchor (MN) in November 2017. Loans including loans held for sale attributable to the Anchor (MN) acquisition totaled \$1.595 billion as of the closing date of the acquisition, which was November 1, 2017.

Average investments increased \$232.1 million for the three months ended June 30, 2018 and \$280.6 million for the six months ended June 30, 2018 when compared to the same periods in 2017 reflecting the Anchor (MN) acquisition.

Average noninterest-bearing deposits increased \$614.6 million for the three months ended June 30, 2018 and \$630.2 million for the six months ended June 30, 2018 when compared to the same periods in 2017. Average interest-bearing deposits increased \$1.334 billion for the three months ended June 30, 2018 and \$1.323 billion for the six months ended June 30, 2018 when compared to the same periods in 2017. The increases in average deposits also reflected the Anchor (MN) acquisition.

Average borrowed funds increased \$277.8 million for the three months ended June 30, 2018 and \$318.2 million for the six months ended June 30, 2018 when compared to the same periods in 2017 primarily due to increased funding needed as a result of growth in our loan portfolio that outpaced deposit growth.

Provision for Loan Losses

The provision for loan losses was \$2.4 million for the three months ended June 30, 2018, compared to \$1.4 million for the three months ended June 30, 2017. Net recoveries totaled \$0.8 million during the three months ended June 30, 2018, compared to net charge-offs of \$0.2 million during the three months ended June 30, 2017. The provision for loan losses was \$2.8 million for the six months ended June 30, 2018, compared to \$1.7 million for the six months ended June 30, 2017. Net recoveries totaled \$0.5 million during the six months ended June 30, 2018, compared to net charge-offs of \$0.5 million during the six months ended June 30, 2017. The higher provision for loan losses is the result of loan growth and increases in the allowance for loan losses related to loans individually evaluated for impairment, partially offset by lower incurred loss rate expectations. Continued loan growth in future periods, a decline in our current level of recoveries, or an increase in charge-offs could result in an increase in provision expense.

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We generate revenues in the form of noninterest income through client fees, sales commissions, and other gains and losses from our core banking franchise and other related businesses, such as wealth management, investment consulting, and investment products. The following table details the components in noninterest income for the three and six months ended June 30, 2018 and 2017:

(dollars in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2018	June 30, 2017	% Change	June 30, 2018	June 30, 2017	% Change
Wealth management fees	\$ 9,746	\$ 9,679	0.7%	\$ 18,772	\$ 18,678	0.5%
Service charges on deposit accounts	10,765					