

CATHAY GENERAL BANCORP  
Form 10-Q  
August 09, 2018

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**UNITED STATES**

**securities and exchange commission**

Washington, D.C. 20549

**form 10-q**

**[ X ] quarterly report pursuant to section 13 or 15(d) of THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2018

**OR**

**[ ] transition report pursuant to section 13 or 15 (d) of the SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 001-31830

Cathay General Bancorp

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(Exact name of registrant as specified in its charter)

|   |                |
|---|----------------|
| Delaware                                      | 95-4274680     |
| (State of other jurisdiction of incorporation | (I.R.S.        |
| or organization)                              | Employer       |
|   | Identification |
|   | No.)           |

|   |            |
|---|------------|
| 777 North Broadway, Los Angeles, California | 90012      |
| (Address of principal executive offices)    | (Zip Code) |

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Registrant's telephone number, including area code: (213) 625-4700

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes            No

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

Yes            No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 Exchange Act).

Yes            No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, \$.01 par value, 81,255,708 shares outstanding as of July 31, 2018.

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**CATHAY GENERAL BANCORP AND SUBSIDIARIES**

**2<sup>ND</sup> quarter 2018 REPORT ON FORM 10-Q**

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**Forward-Looking Statements**

In this Quarterly Report on Form 10-Q, the term “Bancorp” refers to Cathay General Bancorp and the term “Bank” refers to Cathay Bank. The terms “Company,” “we,” “us,” and “our” refer to Bancorp and the Bank collectively.

The statements in this report include forward-looking statements within the meaning of the applicable provisions of the Private Securities Litigation Reform Act of 1995 regarding management’s beliefs, projections, and assumptions concerning future results and events. We intend such forward-looking statements to be covered by the safe harbor provision for forward-looking statements in these provisions. All statements other than statements of historical fact are “forward-looking statements” for purposes of federal and state securities laws, including statements about anticipated future operating and financial performance, financial position and liquidity, growth opportunities and growth rates, growth plans, acquisition and divestiture opportunities, business prospects, strategic alternatives, business strategies, financial expectations, regulatory and competitive outlook, loan and deposit growth, investment and expenditure plans, financing needs and availability, level of nonperforming assets, and other similar forecasts and statements of expectation and statements of assumptions underlying any of the foregoing. Words such as “aims,” “anticipates,” “believes,” “can,” “continue,” “could,” “estimates,” “expects,” “hopes,” “intends,” “may,” “optimistic,” “plans,” “potential,” “possible,” “seeks,” “shall,” “should,” “will,” and variations of these words and similar expressions are intended to identify these forward-looking statements. Forward-looking statements by us are based on estimates, beliefs, projections, and assumptions of management and are not guarantees of future performance. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. Such risks and uncertainties and other factors include, but are not limited to, adverse developments or conditions related to or arising from:

- U.S. and international business and economic conditions;
- possible additional provisions for loan losses and charge-offs;
- credit risks of lending activities and deterioration in asset or credit quality;
- extensive laws and regulations and supervision that we are subject to, including potential supervisory action by bank supervisory authorities;
- increased costs of compliance and other risks associated with changes in regulation, including the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”);
- higher capital requirements from the implementation of the Basel III capital standards;
- compliance with the Bank Secrecy Act and other money laundering statutes and regulations;
- potential goodwill impairment;
- liquidity risk;
- fluctuations in interest rates;
- risks associated with acquisitions and the expansion of our business into new markets;
- inflation and deflation;
- real estate market conditions and the value of real estate collateral;
- environmental liabilities;

our ability to compete, including against larger competitors;

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our ability to retain key personnel;  
successful management of reputational risk;  
natural disasters and geopolitical events;  
general economic or business conditions in Asia, and other regions where the Bank has operations;  
failures, interruptions, or security breaches of our information systems;  
our ability to adapt our systems to technological changes;  
risk management processes and strategies;  
adverse results in legal proceedings;  
the impact of regulatory enforcement actions, if any;  
certain provisions in our charter and bylaws that may affect acquisition of the Company;  
changes in accounting standards or tax laws and regulations;  
market disruption and volatility;  
fluctuations in the Bancorp's stock price;  
restrictions on dividends and other distributions by laws and regulations and by our regulators and our capital structure;  
issuances of preferred stock;  
capital level requirements and successfully raising additional capital, if needed, and the resulting dilution of interests of holders of our common stock; and  
the soundness of other financial institutions.

These and other factors are further described in Bancorp's Annual Report on Form 10-K for the year ended December 31, 2017 (Item 1A in particular), other reports and registration statements filed with the Securities and Exchange Commission ("SEC"), and other filings Bancorp makes with the SEC from time to time. Actual results in any future period may also vary from the past results discussed in this report. Given these risks and uncertainties, readers are cautioned not to place undue reliance on any forward-looking statements, which speak to the date of this report. We have no intention and undertake no obligation to update any forward-looking statement or to publicly announce any revision of any forward-looking statement to reflect future developments or events, except as required by law.

Bancorp's filings with the SEC are available at the website maintained by the SEC at <http://www.sec.gov>, or by request directed to Cathay General Bancorp, 9650 Flair Drive, El Monte, California 91731, Attention: Investor Relations (626) 279-3296.

Table of Contents**PART I – FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS (Unaudited)****CATHAY GENERAL BANCORP AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

| (In thousands, except share and per share data)   | June 30,<br>2018 | December<br>31, 2017 |
|---|------------------|----------------------|
| <b>Assets</b>   |                  |                      |
| Cash and due from banks   | \$ 195,392       | \$ 247,056           |
| Short-term investments and interest bearing deposits  | 208,749          | 292,745              |
| Cash and cash equivalents   | 404,141          | 539,801              |
| Securities available-for-sale (amortized cost of \$1,510,142 at June 30, 2018 and \$1,336,345 at December 31, 2017) | 1,475,949        | 1,333,626            |
| Loans held for sale   | -                | 8,000                |
| Loans   | 13,348,737       | 12,870,290           |
| Less: Allowance for loan losses   | (121,899 )       | (123,279 )           |
| Unamortized deferred loan fees, net   | (3,248 )         | (3,245 )             |
| Loans, net  | 13,223,590       | 12,743,766           |
| Equity securities   | 23,131           | -                    |
| Federal Home Loan Bank stock  | 17,250           | 23,085               |
| Other real estate owned, net  | 8,220            | 9,442                |
| Affordable housing investments and alternative energy partnerships, net   | 308,464          | 272,871              |
| Premises and equipment, net   | 102,415          | 103,064              |
| Customers' liability on acceptances   | 22,366           | 13,482               |
| Accrued interest receivable   | 48,178           | 45,307               |
| Goodwill  | 372,189          | 372,189              |
| Other intangible assets, net  | 7,462            | 8,062                |
| Other assets  | 184,391          | 167,491              |
| Total assets  | \$ 16,197,746    | \$ 15,640,186        |
| <b>Liabilities and Stockholders' Equity</b>   |                  |                      |
| Deposits  |                  |                      |
| Non-interest-bearing demand deposits  | \$ 2,835,314     | \$ 2,783,127         |
| Interest-bearing deposits:  |                  |                      |
| Demand deposits   | 1,381,617        | 1,410,519            |



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|   |               |               |
|---|---------------|---------------|
| Money market deposits   | 2,263,991     | 2,248,271     |
| Savings deposits  | 790,125       | 857,199       |
| Time deposits   | 5,833,499     | 5,390,777     |
| Total deposits  | 13,104,546    | 12,689,893    |
| Securities sold under agreements to repurchase  | 50,000        | 100,000       |
| Advances from the Federal Home Loan Bank  | 480,000       | 430,000       |
| Other borrowings of affordable housing investments  | 17,382        | 17,481        |
| Long-term debt  | 194,136       | 194,136       |
| Deferred payments from acquisition  | 36,015        | 35,404        |
| Acceptances outstanding   | 22,366        | 13,482        |
| Other liabilities   | 228,468       | 186,486       |
| Total liabilities   | 14,132,913    | 13,666,882    |
| Commitments and contingencies   | -             | -             |
| Stockholders' Equity  |               |               |
| Common stock, \$0.01 par value, 100,000,000 shares authorized, 89,466,326 issued and 81,255,683 outstanding at June 30, 2018, and 89,104,022 issued and 80,893,379 outstanding at December 31, 2017 | 895           | 891           |
| Additional paid-in-capital  | 937,224       | 932,874       |
| Accumulated other comprehensive loss, net   | (22,921 )     | (2,511 )      |
| Retained earnings   | 1,389,224     | 1,281,639     |
| Treasury stock, at cost (8,210,643 shares at June 30, 2018, and at December 31, 2017)   | (239,589 )    | (239,589 )    |
| Total equity  | 2,064,833     | 1,973,304     |
| Total liabilities and equity  | \$ 16,197,746 | \$ 15,640,186 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**CATHAY GENERAL BANCORP AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND****COMPREHENSIVE INCOME****(Unaudited)**

|   | Three months ended June 30,                     |            | Six months ended June 30, |            |
|---|---|------------|---------------------------|------------|
|   | 2018  | 2017       | 2018                      | 2017       |
|   | (In thousands, except share and per share data) |            |                           |            |
| <b>Interest and Dividend Income</b>                   |   |            |                           |            |
| Loans receivable, including loan fees                 | \$ 158,659                                      | \$ 129,836 | \$ 309,949                | \$ 254,746 |
| Investment securities                                 | 7,208   | 4,719      | 13,666                    | 9,125      |
| Federal Home Loan Bank stock                          | 380   | 298        | 776                       | 710        |
| Deposits with banks                                   | 1,273   | 776        | 2,829                     | 1,852      |
| Total interest and dividend income                    | 167,520   | 135,629    | 327,220                   | 266,433    |
| <b>Interest Expense</b>                               |   |            |                           |            |
| Time deposits   | 18,730  | 10,769     | 34,458                    | 21,751     |
| Other deposits  | 4,832   | 4,698      | 9,418                     | 9,144      |
| Securities sold under agreements to repurchase        | 608   | 1,065      | 1,322                     | 2,615      |
| Advances from Federal Home Loan Bank                  | 885   | 305        | 1,856                     | 593        |
| Long-term debt  | 2,163   | 1,440      | 4,245                     | 2,864      |
| Deferred payments from acquisition                    | 271   | -          | 547                       | -          |
| Total interest expense                                | 27,489  | 18,277     | 51,846                    | 36,967     |
| Net interest income before reversal for credit losses | 140,031   | 117,352    | 275,374                   | 229,466    |
| Reversal for credit losses                            | -   | -          | (3,000)                   | (2,500)    |
| Net interest income after reversal for credit losses  | 140,031   | 117,352    | 278,374                   | 231,966    |
| <b>Non-Interest Income</b>                            |   |            |                           |            |
| Net losses from equity securities                     | (1,124)   | -          | (4,971)                   | -          |
| Securities gains/(losses), net                        | -   | 3          | -                         | (463)      |
| Letters of credit commissions                         | 1,376   | 1,193      | 2,651                     | 2,316      |
| Depository service fees                               | 1,241   | 1,344      | 2,686                     | 2,852      |
| Gain from acquisition                                 | -   | -          | 340                       | -          |
| Other operating income                                | 6,274   | 3,612      | 12,371                    | 8,165      |
| Total non-interest income                             | 7,767   | 6,152      | 13,077                    | 12,870     |
| <b>Non-Interest Expense</b>                           |   |            |                           |            |
| Salaries and employee benefits                        | 30,600  | 26,145     | 60,977                    | 52,016     |
| Occupancy expense                                     | 5,170   | 4,722      | 10,622                    | 9,421      |
| Computer and equipment expense                        | 2,611   | 2,528      | 5,705                     | 5,252      |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Professional services expense   | 5,730      | 5,343      | 11,769     | 9,599      |
| Data processing service expense   | 3,151      | 2,396      | 6,370      | 4,928      |
| FDIC and regulatory assessments   | 2,142      | 2,189      | 4,177      | 4,709      |
| Marketing expense   | 3,400      | 1,859      | 4,258      | 2,730      |
| Other real estate owned (income)/expense  | (3 )       | 317        | (215 )     | 378        |
| Amortization of investments in low income housing and alternative energy partnerships | 5,113      | 6,224      | 10,874     | 11,074     |
| Amortization of core deposit intangibles  | 280        | 173        | 514        | 345        |
| Acquisition and integration costs   | 1,735      | -          | 1,904      | -          |
| Other operating expense   | 3,159      | 4,762      | 7,104      | 8,092      |
| Total non-interest expense  | 63,088     | 56,658     | 124,059    | 108,544    |
| Income before income tax expense  | 84,710     | 66,846     | 167,392    | 136,292    |
| Income tax expense  | 11,046     | 15,431     | 29,912     | 35,936     |
| Net income  | \$73,664   | \$51,415   | \$137,480  | \$100,356  |
| Other comprehensive income, net of tax  |            |            |            |            |
| Unrealized holding (losses)/gains on securities available-for-sale                    | (2,751 )   | 2,774      | (14,265 )  | 2,278      |
| Unrealized holding gain/(loss) on cash flow hedge derivatives                         | 736        | (550 )     | 2,929      | (251 )     |
| Less: reclassification adjustments for gains/(losses) included in net income          | -          | 2          | -          | (268 )     |
| Total other comprehensive (loss)/gain, net of tax                                     | (2,015 )   | 2,222      | (11,336 )  | 2,295      |
| Total other comprehensive income  | \$71,649   | \$53,637   | \$126,144  | \$102,651  |
| Net income per common share:  |            |            |            |            |
| Basic   | \$0.91     | \$0.64     | \$1.69     | \$1.26     |
| Diluted   | \$0.90     | \$0.64     | \$1.68     | \$1.25     |
| Cash dividends paid per common share  | \$0.24     | \$0.21     | \$0.48     | \$0.42     |
| Average common shares outstanding   |            |            |            |            |
| Basic   | 81,236,315 | 79,840,188 | 81,180,160 | 79,772,268 |
| Diluted   | 81,774,986 | 80,562,607 | 81,727,977 | 80,488,305 |

See accompanying notes to unaudited condensed consolidated financial statements.

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|   | <b>Six months ended June 30</b> |             |
|---|---------------------------------|-------------|
|   | <b>2018</b>                     | <b>2017</b> |
|   | <b>(In thousands)</b>           |             |
| <b>Cash Flows from Operating Activities</b>   |                                 |             |
| Net income  | \$ 137,480                      | \$ 100,356  |
| Adjustments to reconcile net income to net cash provided by operating activities:               |                                 |             |
| Reversal for credit losses  | (3,000 )                        | (2,500 )    |
| Provision for losses on other real estate owned   | -                               | 483         |
| Deferred tax liability  | 2,432                           | 12,227      |
| Depreciation and amortization   | 3,868                           | 3,504       |
| Net gains on sale and transfer of other real estate owned                                       | (459 )                          | (317 )      |
| Proceeds from sales of loans  | 8,000                           | 7,500       |
| Amortization on alternative energy partnerships, venture capital and other investments          | (405 )                          | 1,682       |
| Net loss on sales and calls of securities   | -                               | 438         |
| Amortization/accretion of security premiums/discounts, net                                      | 1,719                           | 1,293       |
| Unrealized loss on equity securities  | 4,971                           | -           |
| Stock based compensation and stock issued to officers as compensation                           | 4,054                           | 3,107       |
| Net change in accrued interest receivable and other assets                                      | (8,043 )                        | 603         |
| Gain on acquisition   | (340 )                          | -           |
| Net change in other liabilities   | (129)                           | 1,857       |
| Net cash provided by operating activities   | 150,148                         | 130,233     |
| <b>Cash Flows from Investing Activities</b>   |                                 |             |
| Purchase of investment securities available-for-sale  | (448,805 )                      | (349,550 )  |
| Proceeds from sale of investment securities available-for-sale                                  | -                               | 99,541      |
| Proceeds from repayments, maturities and calls of investment securities available-for-sale      | 257,339                         | 198,619     |
| Purchase of Federal Home Loan Bank stock  | (5,430 )                        | -           |
| Redemptions of Federal Home Loan Bank stock   | 11,265                          | -           |
| Net increase in loans   | (474,900 )                      | (369,751 )  |
| Purchase of premises and equipment  | (2,706 )                        | (1,718 )    |
| Proceeds from sales of other real estate owned  | 2,785                           | 1,399       |
| Net (increase)/decrease in investment in affordable housing and alternative energy partnerships | (19,201 )                       | (16,685 )   |
| Net cash used for investing activities  | (679,653 )                      | (438,145 )  |
| <b>Cash Flows from Financing Activities</b>   |                                 |             |
| Net increase/(decrease) in deposits   | 414,198                         | (211,228 )  |
|   | (50,000 )                       | (200,000 )  |

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|  |             |            |
|--|-------------|------------|
| Net decrease in federal funds purchased and securities sold under agreements to repurchase |             |            |
| Advances from Federal Home Loan Bank   | 2,450,000   | 795,000    |
| Repayment of Federal Home Loan Bank borrowings   | (2,400,000) | (670,000 ) |
| Cash dividends paid  | (38,966 )   | (33,524 )  |
| Proceeds from issuance of other borrowings   | 20,000      | -          |
| Proceeds from shares issued under Dividend Reinvestment Plan                               | 1,325       | 1,233      |
| Proceeds from exercise of stock options  | 838         | 877        |
| Taxes paid related to net share settlement of RSUs   | (3,550 )    | (5,118 )   |
| Net cash provided by (used in) financing activities  | 393,845     | (322,760 ) |
| Decrease in cash and cash equivalents  | (135,660 )  | (630,672 ) |
| Cash and cash equivalents, beginning of the period   | 539,801     | 1,185,084  |
| Cash and cash equivalents, end of the period   | \$404,141   | \$554,412  |
| Supplemental disclosure of cash flow information   |             |            |
| Cash paid during the period:   |             |            |
| Interest   | \$49,606    | \$39,259   |
| Income taxes paid  | \$31,589    | \$30,096   |
| Non-cash investing and financing activities:   |             |            |
| Net change in unrealized holding loss on securities available-for-sale, net of tax         | \$(14,265 ) | \$2,546    |
| Net change in unrealized holding loss on cash flow hedge derivatives                       | \$2,929     | \$(251 )   |
| Transfers to other real estate owned from loans held for investment                        | \$715       | \$726      |

See accompanying notes to unaudited condensed consolidated financial statements.

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**CATHAY GENERAL BANCORP AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**1. Business**

Cathay General Bancorp (“Bancorp”) is the holding company for Cathay Bank (the “Bank” and, together, with Bancorp, the “Company”), eight limited partnerships investing in affordable housing investments in which the Bank is the sole limited partner, Asia Realty Corp. and GBC Venture Capital, Inc. Bancorp also owns 100% of the common stock of five statutory business trusts created for the purpose of issuing capital securities. The Bank was founded in 1962 and offers a wide range of financial services. As of June 30, 2018, the Bank operates 26 branches in Southern California, 14 branches in Northern California, 12 branches in New York State, three branches in Illinois, three branches in Washington State, two branches in Texas, one branch in Massachusetts, New Jersey, Maryland and Nevada, one branch in Hong Kong, and a representative office in Beijing, Shanghai and Taipei. Deposit accounts at the Hong Kong branch are not insured by the Federal Deposit Insurance Corporation (the “FDIC”).

**2. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. For further information, refer to the audited consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

The preparation of the condensed consolidated financial statements in accordance with GAAP requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. The Company expects that the most significant estimates subject to change are the allowance for loan losses.

In the condensed consolidated statement of cash flows, the amounts for the six months ended June 30, 2017 have been corrected in the current year and differ from the previously reported amounts of \$135.0 million for net cash provided by investing activities, \$57.5 million for decrease in cash and cash equivalents, \$218.0 million for cash and cash equivalents, beginning of period and \$160.5 million for cash and cash equivalents, end of period.

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**3. Recent Accounting Pronouncements**

***Accounting Standards adopted in 2018***

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606).” The new guidance replaces existing revenue recognition guidance for contracts to provide goods or services to customers and amends existing guidance related to recognition of gains and losses on the sale of certain nonfinancial assets such as real estate. ASU 2014-09 clarifies the principles for recognizing revenue and replaces nearly all existing revenue recognition guidance in U.S. GAAP. Quantitative and qualitative disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers are also required. ASU 2014-09 as amended by ASU 2015-14, ASU 2016-08, ASU 2016-10 and ASU 2016-12, is effective for interim and annual periods beginning after December 15, 2017 and is applied on either a modified retrospective or full retrospective basis. Our revenue is primarily comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. Accordingly, the majority of the Company’s revenues will not be affected. In addition, the new standard does not materially impact the timing or measurement of the Company’s revenue recognition as it is consistent with the Company’s existing accounting for contracts within the scope of the new standard. The Company adopted this guidance as of January 1, 2018 using the modified retrospective method where there was no cumulative effect adjustment to retained earnings as a result of adopting this new standard. In addition, the standard did not have a material impact on our consolidated financial statements. The Company has provided a disaggregation of the significant categories of revenues within the scope of this guidance and expanded the qualitative disclosures of the Company’s noninterest income. See footnote 17 - Revenue from Contracts with Customers for additional information.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” This update requires an entity to measure equity investments with readily determinable fair values at fair value with changes in fair value recognized in net income. Equity investment without readily determinable fair values will be measured at fair value either upon the occurrence of an observable price change or upon identification of an impairment and any amount by which the carrying value exceeding the fair value will be recognized as an impairment in net income. This update also requires an entity to disclose fair value of financial instruments measured at amortized cost on the balance sheet to measure that fair value using the exit price option. In addition, this update requires separate presentation in comprehensive income for changes in the fair value of a liability and in the balance sheet by measurement category and form of financial asset. ASU 2016-01 becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of the amendment resulted in approximately \$8.6 million being reclassified from accumulated other comprehensive income to retained earnings, representing an increase to retained earnings as of January 1, 2018, and reduced pre-tax income by \$1.1 million for the three months ended June 30, 2018 and \$5.0 million for the six months ended June 30, 2018. See footnote 7 – Investment Securities. Also, beginning in the first quarter of 2018, the Company is adopting the exit price notion on fair value measurement of its loan portfolio. As a result of this fair value change, the prior-year figures shown for loans on footnote - 13 for comparative purposes will no longer be comparable.





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In February 2018, FASB issued ASU 2018-02 to help organizations address certain stranded income tax effects in accumulated other comprehensive income (“AOCI”) resulting from the Tax Cuts and Jobs Act of 2017 (the “Tax Legislation”). The amendment 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 changes in the U.S. federal corporate income tax rate in the Tax Legislation (or portion thereof) is recorded. The amendment also includes disclosure requirements regarding the issuer’s accounting policy for releasing income tax effects from AOCI. The amendment is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, and organizations should apply the provisions of the amendment either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Legislation is recognized. The Company has elected to reclassify the income tax effects of the Tax Legislation from accumulated other comprehensive income to retained earnings effective January 1, 2018. This resulted in the reclassification of \$515,000 from accumulated other comprehensive income to retained earnings, representing an increase to retained earnings as of January 1, 2018. See footnote 18 – Stockholders Equity.

## *Other Accounting Standards*

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which is intended to increase transparency and comparability in the accounting for lease transactions. ASU 2016-02 requires lessees to recognize all leases longer than twelve months on the consolidated balance sheet as lease assets and lease liabilities and quantitative and qualitative disclosures regarding key information about leasing arrangements. Lessor accounting is largely unchanged. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years with an option to early adopt. ASU 2016-02 mandates a modified retrospective transition method for all entities. The Company is evaluating the impact of ASU 2016-02 and has determined that the majority of our leases are operating leases. We expect, upon adoption, that the Company will record a liability for the remaining obligation under the lease agreements and a corresponding right-of-use asset in its consolidated financial statements. ASU 2016-02 will be effective for us on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” This update requires an entity to use a broader range of reasonable and supportable forecasts, in addition to historical experience and current conditions, to develop an expected credit loss estimate for financial assets and net investments that are not accounted for at fair value through net income. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses to the amount by which fair value is below amortized cost. ASU 2016-13 becomes effective for interim and annual periods beginning after December 15, 2019. The Company has designated a management team and begun its implementation efforts by identifying key interpretive issues, assessing its processes and identifying the system requirements against the new guidance to determine what modifications may be required. The implementation efforts also involve, but are not limited to, assessing potential macroeconomic factors that will be used to determine the reasonable and supportable forecast period. The Company has not yet determined the effect of ASU 2016-13 on its accounting policies or the impact on the Company’s consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, “Intangibles—Goodwill and Other (Topic 350)”: Simplifying the Test for Goodwill Impairment.” This update simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit’s goodwill with the carrying amount of that goodwill. Adoption of this update is on a prospective basis and the amendments in this update are to be applied to annual periods beginning after December 15, 2019. Adoption of ASU 2017-04 is not expected to have a significant impact on the Company’s consolidated financial statements.

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In March 2017, the FASB issued ASU 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. The amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. This update affects all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Adoption of ASU 2017-08 is not expected to have a significant impact on the Company’s consolidated financial statements.

In July 2017, the FASB issued ASU 2017-11, “Earnings per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480) and Derivatives and Hedging (Topic 815).” There are two parts to this update. Part I of this update addresses the complexity of accounting for certain financial instruments with down round features. Down round features are features of certain equity-linked instruments that result in the strike price being reduced on the basis of the pricing of future equity offerings. Part II of this update addresses the difficulty in navigating topic 480, Distinguishing Liabilities from Equity, because of the existence of extensive pending content in the FASB Accounting Standards Codification. This pending content is the result of the indefinite deferral of accounting requirements about mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests. The amendments in this update are effective for fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in part I of this update should be applied in either of the following ways: (i) Retrospectively to outstanding financial instruments with a down round feature by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first fiscal year and interim periods in which the pending content that links to this paragraph is effective; or (ii) Retrospectively to outstanding financial instruments with a down round feature for each prior reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10. The amendments to Part II of this update do not require any transition guidance because those amendments do not have an accounting effect. The Company is currently evaluating the impact on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815)”, which targeted improvements to accounting for hedging activities. 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. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Company is currently evaluating the impact on its consolidated financial statements.



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**4. Acquisition**

On July 14, 2017, the Company completed the acquisition of SinoPac Bancorp, the parent of Far East National Bank (“FENB”), pursuant to a Stock Purchase Agreement, dated as of July 8, 2016, by and between the Company and Bank SinoPac Co. Ltd. Under the terms of the Stock Purchase Agreement, the Company purchased all of the issued and outstanding share capital of SinoPac Bancorp for an aggregate purchase price of \$351.6 million plus additional post closing payments based on the realization of certain assets of FENB. The Company issued 926,192 shares of common stock as consideration and the remainder of the consideration is payable in cash of which \$100 million was deferred and paid on November 14, 2017 and \$35.4 million was deferred and will be released over the next three years. On December 12, 2017, additional cash consideration of \$4.1 million was paid based on the realized gain from the sale of the building that housed FENB’s former Alhambra, California branch. SinoPac Bancorp was merged into Cathay General Bancorp on July 17, 2017 and subsequently, on October 27, 2017, FENB was merged into Cathay Bank. The acquisition allowed the Company to expand its number of branches in California. Prior to the closing of the acquisition, FENB operated nine branches in California, and a representative office in Beijing. The acquisition is accounted for as a business combination, subject to the provisions of ASC 805-10-50, Business Combinations.

The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the July 14, 2017 acquisition date. We have included the financial results of the business combinations in the condensed consolidated statement of income beginning on the acquisition date. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the acquisition date. We made significant estimates and exercised significant judgement in estimating fair values and accounting for such acquired assets and liabilities. The assets and liabilities have been accounted for under the acquisition method of accounting.

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The fair value of the assets and the liabilities acquired as of July 14, 2017 are shown below:

|  | SinoPac<br>Bancorp |
|--|--------------------|
| <b>Assets acquired:</b>                        |                    |
| Cash and cash equivalents                      | \$ 166,932         |
| Short-term investments                         | 122,000            |
| Securities available-for-sale                  | 88,044             |
| FHLB and FRB stock                             | 19,890             |
| Loans  | 705,792            |
| Premises and equipment                         | 6,239              |
| Cash surrender value of life insurance         | 46,083             |
| Deferred tax assets, net                       | 40,690             |
| Core deposit intangible                        | 6,122              |
| Accrued interest receivable and other assets   | 10,689             |
| Total assets acquired                          | 1,212,481          |
| <b>Liabilities assumed:</b>                    |                    |
| Deposits                                       | 813,888            |
| Advances from the Federal Home Loan Bank       | 30,000             |
| Accrued interest payable and other liabilities | 8,512              |
| Total liabilities assumed                      | 852,400            |
| <b>Net assets acquired</b>                     | <b>\$ 360,081</b>  |
| <br>   |                    |
| Cash paid                                      | \$ 284,984         |
| Fair value of common stock issued              | 34,862             |
| <b>Total consideration paid</b>                | <b>\$ 319,846</b>  |
| <br>   |                    |
| Purchase price payable to SinoPac              | 34,267             |
| <b>Total consideration</b>                     | <b>\$ 354,113</b>  |
| <b>Gain from acquisition</b>                   | <b>\$ 5,968</b>    |

The table above reflects net purchase price adjustments of \$340,000 related to contingent consideration and imputed interest adjustments made during the six months ended June 30, 2018.

Table of Contents**5. Earnings per Share**

Basic earnings per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and resulted in the issuance of common stock that then shared in earnings. Outstanding stock options and restricted stock units with anti-dilutive effect were not included in the computation of diluted earnings per share. The following table sets forth earnings per common share calculations:

| (Dollars in thousands, except share and per share data)                    | Three months ended June 30, |            | Six months ended June 30, |            |
|--|-----------------------------|------------|---------------------------|------------|
|  | 2018                        | 2017       | 2018                      | 2017       |
| Net income   | \$73,664                    | \$51,415   | \$137,480                 | \$100,356  |
| Weighted-average shares:   |                             |            |                           |            |
| Basic weighted-average number of common shares outstanding                 | 81,236,315                  | 79,840,188 | 81,180,160                | 79,772,268 |
| Dilutive effect of weighted-average outstanding common share equivalents   |                             |            |                           |            |
| Warrants   | 278,080                     | 410,677    | 286,718                   | 413,625    |
| Options  | -                           | 24,169     | -                         | 29,002     |
| Restricted stock units   | 260,591                     | 287,573    | 261,099                   | 273,410    |
| Diluted weighted-average number of common shares outstanding               | 81,774,986                  | 80,562,607 | 81,727,977                | 80,488,305 |
| Average stock options and restricted stock units with anti-dilutive effect | 6,521                       | -          | 22,624                    | 9,895      |
| Earnings per common share:   |                             |            |                           |            |
| Basic  | \$0.91                      | \$0.64     | \$1.69                    | \$1.26     |
| Diluted  | \$0.90                      | \$0.64     | \$1.68                    | \$1.25     |

**6. Stock-Based Compensation**

Under the Company's equity incentive plans, directors and eligible employees may be granted incentive or non-statutory stock options, restricted stock units ("RSUs") and/or awarded non-vested stock. As of June 30, 2018, there were no stock options outstanding.



There were 35,880 and 37,540 stock option shares exercised in the six months ended June 30, 2018 and 2017, respectively. The Company received \$838,000 from the exercise of stock options for 35,880 shares at \$23.37 per share that had an aggregate intrinsic value of \$718,000 during the six months ended June 30, 2018 compared to \$877,000 from the exercise of stock options that had an aggregate intrinsic value of \$534,000 during the six months ended June 30, 2017.

RSUs are granted under the Company's long-term incentive plan at no cost to the recipient. RSUs generally vest ratably over three years or cliff vest after one or three years of continued employment from the date of the grant. While a portion of RSUs are time-vesting awards, others vest subject to the attainment of specified performance goals referred to as "Performance-based RSUs." All RSUs are subject to forfeiture until vested.

Performance-based RSUs are granted at the target amount of awards. Based on the Company's attainment of specified performance goals and consideration of market conditions, the number of shares that vest can be adjusted to a minimum of zero and to a maximum of 150% of the target. The amount of performance-based RSUs that are eligible to vest is determined at the end of each performance period and is then added together to determine the total number of performance shares that are eligible to vest. Performance-based RSUs generally cliff vest three years from the date of grant.

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Compensation costs for the time-based awards are based on the quoted market price of the Company's stock at the grant date. Compensation costs associated with performance-based RSUs are based on grant date fair value, which considers both market and performance conditions. Compensation costs of both time-based and performance-based awards are recognized on a straight-line basis from the grant date until the vesting date of each grant.

The following table presents restricted stock unit activity during the six months ended June 30, 2018:

|                              | Time-Based RSUs |  | Performance-Based RSUs |  |
|------------------------------|-----------------|--|------------------------|--|
|                              | Shares          | Weighted-Average<br>Grant Date<br>Fair Value | Shares                 | Weighted-Average<br>Grant Date<br>Fair Value |
|                              |                 |  |                        |  |
| Balance at December 31, 2017 | 221,738         | 32.72  | 339,872                | 33.52  |
| Granted                      | 128,589         | 43.36  | 55,455                 | 39.46  |
| Vested                       | (65,721 )       | 41.59  | (68,459 )              | 41.22  |
| Forfeited                    | (8,774 )        | 35.29  | -                      | -  |
| Balance at June 30, 2018     | 275,832         | 35.48  | 326,868                | 32.91  |

The compensation expense recorded for RSUs was \$1.9 million for the three months ended June 30, 2018, compared to \$1.4 million in the same period a year ago. For the six months ended June 30, 2018 and 2017, compensation expense recorded relating to the RSUs was \$3.4 million and \$2.6 million, respectively. Unrecognized stock-based compensation expense related to RSUs was \$13.3 million and \$10.6 million as of June 30, 2018 and 2017, respectively. These costs are expected to be recognized over the next 2.1 years and 2.2 years for time-based and performance-based RSUs, respectively.

As of June 30, 2018, 2,591,461 shares were available under the Company's 2005 Incentive Plan (as Amended and Restated) for future grants.

Tax benefit from share-based payment arrangements of \$0.8 million reduced income tax expense in the first six months of 2018 compared to \$2.6 million in the same period a year ago.

Table of Contents7. Investment Securities

Securities available-for-sale were \$1.5 billion as of June 30, 2018, compared to \$1.3 billion as of December 31, 2017.

The following tables reflect the amortized cost, gross unrealized gains, gross unrealized losses, and fair value of securities available-for-sale as of June 30, 2018, and investment securities as of December 31, 2017:

|                                     | June 30, 2018  |            |            |             |
|-------------------------------------|----------------|------------|------------|-------------|
|                                     | Amortized      | Gross      | Gross      |             |
|                                     | Cost           | Unrealized | Unrealized |             |
|                                     |                | Gains      | Losses     | Fair Value  |
|                                     | (In thousands) |            |            |             |
| Debt Securities Available-for-Sale  |                |            |            |             |
| U.S. treasury securities            | \$348,677      | \$ 8       | \$ 141     | \$348,544   |
| U.S. government agency entities     | 8,397          | -          | 208        | 8,189       |
| U.S. government sponsored entities  | 400,000        | -          | 16,041     | 383,959     |
| Mortgage-backed securities          | 676,855        | 189        | 18,756     | 658,288     |
| Collateralized mortgage obligations | 1,233          | -          | 30         | 1,203       |
| Corporate debt securities           | 74,980         | 786        | -          | 75,766      |
| Total                               | \$1,510,142    | \$ 983     | \$ 35,176  | \$1,475,949 |

|  | December 31, 2017 |            |            |             |
|--|-------------------|------------|------------|-------------|
|  | Amortized         | Gross      | Gross      |             |
|  | Cost              | Unrealized | Unrealized |             |
|  |                   | Gains      | Losses     | Fair Value  |
|  | (In thousands)    |            |            |             |
| <b>Securities Available-for-Sale</b>             |                   |            |            |             |
| U.S. treasury securities                         | \$249,877         | \$ -       | \$ 357     | \$249,520   |
| U.S. government agency entities                  | 9,047             | 11         | 70         | 8,988       |
| U.S. government sponsored entities               | 400,000           | -          | 9,664      | 390,336     |
| State and municipal securities                   | 1,944             | -          | 30         | 1,914       |
| Mortgage-backed securities                       | 577,987           | 241        | 6,259      | 571,969     |
| Collateralized mortgage obligations              | 1,533             | -          | 17         | 1,516       |
| Corporate debt securities                        | 80,007            | 1,291      | 17         | 81,281      |
| Mutual funds                                     | 6,500             | -          | 270        | 6,230       |
| Preferred stock of government sponsored entities | 5,842             | 4,260      | -          | 10,102      |
| Other equity securities                          | 3,608             | 8,162      | -          | 11,770      |
| Total  | \$1,336,345       | \$ 13,965  | \$ 16,684  | \$1,333,626 |

The amortized cost and fair value of investment securities as of June 30, 2018, by contractual maturities, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or repayment penalties.

|  | <b>Securities<br/>Available-For-Sale<br/>Amortized cost      Fair value<br/>(In thousands)</b> |             |
|--|--|-------------|
| Due in one year or less                | \$358,743  | \$358,622   |
| Due after one year through five years  | 465,994  | 450,736     |
| Due after five years through ten years | 4,478  | 4,314       |
| Due after ten years                    | 680,927  | 662,277     |
| Total                                  | \$1,510,142  | \$1,475,949 |

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There were no sales of mortgage-backed securities during the first six months of 2018 and the first six months of 2017. Proceeds from repayments, maturities and calls of mortgage-backed securities were \$50.4 million and \$28.6 million for the six months ended June 30, 2018 and 2017, respectively. There were no sales of other investment securities during the first six months of 2018, compared to proceeds of \$99.5 million from the sale of other investment securities during the first six months of 2017. Proceeds from maturities and calls of other investment securities were \$206.9 million during the six months ended June 30, 2018, compared to \$170.0 million during the same period a year ago. There were no gains or losses on sales of investment securities during the six months ended June 30, 2018, compared to \$438,000 of losses in the same period a year ago. There were no other than temporary impairment write-downs recorded during the first six months of 2018, compared to \$25,000 recorded during the first six months of 2017.

The adoption of ASU 2016-01 resulted in approximately \$8.6 million being reclassified from accumulated other comprehensive income to retained earnings, representing an increase to retained earnings as of January 1, 2018. For the six months ended, June 30, 2018, the Company recognized a net loss of \$5.0 million due to the decrease in fair value of equity investments with readily determinable fair values. Equity securities were \$23.1 million as of June 30, 2018, compared to \$28.1 million as of December 31, 2017.

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The tables below show the fair value and unrealized losses of the temporarily impaired securities in our investment securities portfolio as of June 30, 2018, and December 31, 2017:

| <b>June 30, 2018</b>                             |                            |                   |                            |                   |              |                   |
|--|----------------------------|-------------------|----------------------------|-------------------|--------------|-------------------|
| <b>Temporarily impaired securities</b>           |                            |                   |                            |                   |              |                   |
|  | <b>Less than 12 months</b> |                   | <b>12 months or longer</b> |                   | <b>Total</b> |                   |
|  | <b>Fair</b>                | <b>Unrealized</b> | <b>Fair</b>                | <b>Unrealized</b> | <b>Fair</b>  | <b>Unrealized</b> |
|  | <b>Value</b>               | <b>Losses</b>     | <b>Value</b>               | <b>Losses</b>     | <b>Value</b> | <b>Losses</b>     |
| <b>(In thousands)</b>                            |                            |                   |                            |                   |              |                   |
| <b>Debt Securities Available-for-Sale</b>        |                            |                   |                            |                   |              |                   |
| U.S. treasury securities                         | \$ 124,463                 | \$ 49             | \$ 49,906                  | \$ 92             | \$ 174,369   | \$ 141            |
| U.S. government agency entities                  | 8,189                      | 208               | -                          | -                 | 8,189        | 208               |
| U.S. government sponsored entities               | -                          | -                 | 383,959                    | 16,041            | 383,959      | 16,041            |
| Mortgage-backed securities                       | 465,499                    | 12,349            | 160,485                    | 6,407             | 625,984      | 18,756            |
| Collateralized mortgage obligations              | 1,203                      | 30                | -                          | -                 | 1,203        | 30                |
| Total debt securities                            | \$ 599,354                 | \$ 12,636         | \$ 594,350                 | \$ 22,540         | \$ 1,193,704 | \$ 35,176         |
| <b>Equity Securities</b>                         |                            |                   |                            |                   |              |                   |
| Preferred stock of government sponsored entities | 7,480                      | 2,623             | -                          | -                 | 7,480        | 2,623             |
| Mutual funds                                     | -                          | -                 | 6,082                      | 148               | 6,082        | 148               |
| Other equity securities                          | 9,569                      | 2,200             | -                          | -                 | 9,569        | 2,200             |
| Total equity securities                          | \$ 17,049                  | \$ 4,823          | \$ 6,082                   | \$ 148            | \$ 23,131    | \$ 4,971          |

| <b>December 31, 2017</b>               |                            |                   |                            |                   |              |                   |
|--|----------------------------|-------------------|----------------------------|-------------------|--------------|-------------------|
| <b>Temporarily impaired securities</b> |                            |                   |                            |                   |              |                   |
|  | <b>Less than 12 months</b> |                   | <b>12 months or longer</b> |                   | <b>Total</b> |                   |
|  | <b>Fair</b>                | <b>Unrealized</b> | <b>Fair</b>                | <b>Unrealized</b> | <b>Fair</b>  | <b>Unrealized</b> |
|  | <b>Value</b>               | <b>Losses</b>     | <b>Value</b>               | <b>Losses</b>     | <b>Value</b> | <b>Losses</b>     |
| <b>(In thousands)</b>                  |                            |                   |                            |                   |              |                   |
| <b>Securities Available-for-Sale</b>   |                            |                   |                            |                   |              |                   |
| U.S. treasury securities               | \$ 199,823                 | \$ 62             | \$ 49,697                  | \$ 295            | \$ 249,520   | \$ 357            |
| U.S. government agency entities        | 5,711                      | 70                | -                          | -                 | 5,711        | 70                |
| U.S. government sponsored entities     | -                          | -                 | 390,336                    | 9,664             | 390,336      | 9,664             |
| State and municipal securities         | 1,914                      | 30                | -                          | -                 | 1,914        | 30                |
| Mortgage-backed securities             | 342,436                    | 3,147             | 178,617                    | 3,112             | 521,053      | 6,259             |
| Collateralized mortgage obligations    | 1,516                      | 17                | -                          | -                 | 1,516        | 17                |
| Corporate debt securities              | 5,015                      | 17                | -                          | -                 | 5,015        | 17                |
| Mutual funds                           | -                          | -                 | 6,230                      | 270               | 6,230        | 270               |

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|       |           |          |           |           |             |           |
|-------|-----------|----------|-----------|-----------|-------------|-----------|
| Total | \$556,415 | \$ 3,343 | \$624,880 | \$ 13,341 | \$1,181,295 | \$ 16,684 |
|-------|-----------|----------|-----------|-----------|-------------|-----------|

As of June 30, 2018, the Company had unrealized losses on available-for-sale securities of \$35.2 million. The unrealized losses on these securities were primarily attributed to yield curve movement, together with widened liquidity spreads and credit spreads. The issuers have not, to the Company's knowledge, established any cause for default on these securities. Management believes the impairment was temporary and, accordingly, no impairment loss on these securities has been recognized in our condensed consolidated statements of operations. The Company expects to recover the amortized cost basis of its securities and has no intent to sell, and will not be required to sell, available-for-sale securities that have declined below their cost before their anticipated recovery.

Investment securities having a carrying value of \$158.1 million as of June 30, 2018, and \$272.2 million as of December 31, 2017, were pledged to secure public deposits, other borrowings, treasury tax and loan, and securities sold under agreements to repurchase.

Table of Contents**8. Loans**

Most of the Company's business activities are with customers located in the high-density Asian-populated areas of Southern and Northern California; New York City, New York; Dallas and Houston, Texas; Seattle, Washington; Boston, Massachusetts; Chicago, Illinois; Edison, New Jersey; Rockville, Maryland; Las Vegas, Nevada, and Hong Kong. The Company has no specific industry concentration, and generally its loans are secured by real property or other collateral of the borrowers. The Company generally expects loans to be paid off from the operating profits of the borrowers, from refinancing by other lenders, or through sale by the borrowers of the secured collateral.

The types of loans in the Company's condensed consolidated balance sheets as of June 30, 2018, and December 31, 2017, were as follows:

|                                | June 30,<br>2018      | December<br>31, 2017 |
|--------------------------------|-----------------------|----------------------|
|                                | <b>(In thousands)</b> |                      |
| Commercial loans               | \$2,576,649           | \$2,461,266          |
| Residential mortgage loans     | 3,378,875             | 3,062,050            |
| Commercial mortgage loans      | 6,615,791             | 6,482,695            |
| Real estate construction loans | 581,917               | 678,805              |
| Equity lines                   | 191,445               | 180,304              |
| Installment & other loans      | 4,060                 | 5,170                |
| Gross loans                    | \$13,348,737          | \$12,870,290         |
| Allowance for loan losses      | (121,899 )            | (123,279 )           |
| Unamortized deferred loan fees | (3,248 )              | (3,245 )             |
| Total loans, net               | \$13,223,590          | \$12,743,766         |
| Loans held for sale            | \$-                   | \$8,000              |

As of June 30, 2018, recorded investment in impaired loans totaled \$137.2 million and was comprised of non-accrual loans, excluding loans held for sale, of \$52.7 million and accruing troubled debt restructured loans ("TDRs") of \$84.5 million. As of December 31, 2017, recorded investment in impaired loans totaled \$117.4 million and was comprised of non-accrual loans, excluding loans held for sale, of \$48.8 million and accruing TDRs of \$68.6 million. For impaired loans, the amounts previously charged off represent 6.5% as of June 30, 2018, and 7.2% as of December 31, 2017, of the contractual balances for impaired loans.





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The following table presents the average balance and interest income recognized related to impaired loans for the periods indicated:

|   | <b>Impaired Loans<br/>Average Recorded Investment</b> |           |                  |           | <b>Interest Income Recognized</b> |       |                  |         |
|---|---|-----------|------------------|-----------|-----------------------------------|-------|------------------|---------|
|   | Three months ended                                    |           | Six months ended |           | Three months ended                |       | Six months ended |         |
|   | June 30,  |           | June 30,         |           | June 30,                          |       | June 30,         |         |
|   | 2018  | 2017      | 2018             | 2017      | 2018                              | 2017  | 2018             | 2017    |
|   | <b>(In thousands)</b>                                 |           |                  |           |                                   |       |                  |         |
| Commercial loans                            | \$46,763  | \$19,376  | \$45,978         | \$21,345  | \$498                             | \$86  | \$825            | \$171   |
| Real estate construction loans              | 8,378   | 42,752    | 8,258            | 29,912    | -                                 | 356   | -                | 696     |
| Commercial mortgage loans                   | 64,004  | 60,295    | 61,316           | 60,847    | 633                               | 445   | 1,264            | 898     |
| Residential mortgage loans and equity lines | 14,664  | 15,172    | 14,189           | 15,854    | 93                                | 107   | 186              | 211     |
| Total impaired loans                        | \$133,809   | \$137,595 | \$129,741        | \$127,958 | \$1,224                           | \$994 | \$2,275          | \$1,976 |

The following table presents impaired loans and the related allowance for loan losses as of the dates indicated:

|   | <b>Impaired Loans<br/>June 30, 2018</b> |                   |                  | <b>December 31, 2017</b> |                   |                  |
|---|---|-------------------|------------------|--------------------------|-------------------|------------------|
|   | <b>Unpaid</b>                           |                   |                  | <b>Unpaid</b>            |                   |                  |
|   | <b>Recorded</b>                         |                   |                  | <b>Recorded</b>          |                   |                  |
|   | <b>Principal</b>                        | <b>Investment</b> | <b>Allowance</b> | <b>Principal</b>         | <b>Investment</b> | <b>Allowance</b> |
|   | <b>Balance</b>                          |                   |                  | <b>Balance</b>           |                   |                  |
|   | <b>(In thousands)</b>                   |                   |                  |                          |                   |                  |
| <b>With no allocated allowance</b>          |   |                   |                  |                          |                   |                  |
| Commercial loans                            | \$51,143                                | \$49,521          | \$-              | \$43,483                 | \$42,702          | \$-              |
| Real estate construction loans              | 8,821                                   | 8,040             | -                | 8,821                    | 8,185             | -                |
| Commercial mortgage loans                   | 41,970                                  | 34,508            | -                | 37,825                   | 31,029            | -                |
| Residential mortgage loans and equity lines | 6,551                                   | 6,543             | -                | 1,301                    | 1,301             | -                |
| Subtotal                                    | \$108,485                               | \$98,612          | \$-              | \$91,430                 | \$83,217          | \$-              |
| <b>With allocated allowance</b>             |   |                   |                  |                          |                   |                  |
| Commercial loans                            | \$3,247                                 | \$3,218           | \$2,463          | \$891                    | \$793             | \$43             |
| Commercial mortgage loans                   | 27,495                                  | 27,445            | 1,036            | 21,733                   | 21,635            | 1,738            |
| Residential mortgage loans and equity lines | 9,143                                   | 7,939             | 334              | 13,022                   | 11,708            | 353              |
| Subtotal                                    | \$39,885                                | \$38,602          | \$3,833          | \$35,646                 | \$34,136          | \$2,134          |
| <b>Total impaired loans</b>                 | <b>\$148,370</b>                        | <b>\$137,214</b>  | <b>\$3,833</b>   | <b>\$127,076</b>         | <b>\$117,353</b>  | <b>\$2,134</b>   |



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The following tables present the aging of the loan portfolio by type as of June 30, 2018, and as of December 31, 2017:

|   | June 30, 2018     |               |             | Non-accrual<br>Loans | Total<br>Past<br>Due | Loans Not<br>Past<br>Due | Total        |
|---|-------------------|---------------|-------------|----------------------|----------------------|--------------------------|--------------|
|   | 30-59<br>Days     | 60-89<br>Days | 90<br>Days  |                      |                      |                          |              |
|   | Past<br>Due       | Past<br>Due   | or<br>More  |                      |                      |                          |              |
|   | Past<br>Due       | Past<br>Due   | Past<br>Due |                      |                      |                          |              |
| (In thousands)                              |                   |               |             |                      |                      |                          |              |
| Type of Loans:                              |                   |               |             |                      |                      |                          |              |
| Commercial loans                            | \$9,537           | \$34,500      | \$ -        | \$ 19,212            | \$63,249             | \$2,513,400              | \$2,576,649  |
| Real estate construction loans              | -                 | -             | -           | 8,040                | 8,040                | 573,877                  | 581,917      |
| Commercial mortgage loans                   | 841               | 14,350        | -           | 17,154               | 32,345               | 6,583,446                | 6,615,791    |
| Residential mortgage loans and equity lines | 423               | 1,542         | -           | 8,322                | 10,287               | 3,560,033                | 3,570,320    |
| Installment and other loans                 | -                 | -             | -           | -                    | -                    | 4,060                    | 4,060        |
| Total loans                                 | \$10,801          | \$50,392      | \$ -        | \$ 52,728            | \$113,921            | \$13,234,816             | \$13,348,737 |
|   |                   |               |             |                      |                      |                          |              |
|   | December 31, 2017 |               |             | Non-accrual<br>Loans | Total<br>Past<br>Due | Loans Not<br>Past<br>Due | Total        |
|   | 30-59<br>Days     | 60-89<br>Days | 90<br>Days  |                      |                      |                          |              |
|   | Past<br>Due       | Past<br>Due   | or<br>More  |                      |                      |                          |              |
|   | Past<br>Due       | Past<br>Due   | Past<br>Due |                      |                      |                          |              |
| (In thousands)                              |                   |               |             |                      |                      |                          |              |
| Type of Loans:                              |                   |               |             |                      |                      |                          |              |
| Commercial loans                            | \$11,079          | \$5,192       | \$ -        | \$ 14,296            | \$30,567             | \$2,430,699              | \$2,461,266  |
| Real estate construction loans              | 3,028             | -             | -           | 8,185                | 11,213               | 667,592                  | 678,805      |
| Commercial mortgage loans                   | 17,573            | 5,602         | -           | 19,820               | 42,995               | 6,439,700                | 6,482,695    |
| Residential mortgage loans and equity lines | 6,613             | 732           | -           | 6,486                | 13,831               | 3,228,523                | 3,242,354    |
| Installment and other loans                 | 103               | -             | -           | -                    | 103                  | 5,067                    | 5,170        |
| Total loans                                 | \$38,396          | \$11,526      | \$ -        | \$ 48,787            | \$98,709             | \$12,771,581             | \$12,870,290 |

The determination of the amount of the allowance for loan losses for impaired loans is based on management's current judgment about the credit quality of the loan portfolio and takes into consideration known relevant internal and

external factors that affect collectability when determining the appropriate level for the allowance for loan losses. The nature of the process by which the Bank determines the appropriate allowance for loan losses requires the exercise of considerable judgment. This allowance evaluation process is also applied to troubled debt restructurings since they are considered to be impaired loans. The allowance for loan losses and the reserve for off-balance sheet credit commitments are significant estimates that can and do change based on management's process in analyzing the loan portfolio and on management's assumptions about specific borrowers, underlying collateral, and applicable economic and environmental conditions, among other factors.

A troubled debt restructuring is a formal modification of the terms of a loan when the lender, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including a change in the stated interest rate, a reduction in the loan balance or accrued interest, or an extension of the maturity date that causes significant delay in payment.

TDRs on accrual status are comprised of the loans that have, pursuant to the Bank's policy, performed under the restructured terms and have demonstrated sustained performance under the modified terms for six months before being returned to accrual status. The sustained performance considered by management pursuant to its policy includes the periods prior to the modification if the prior performance met or exceeded the modified terms. This would include cash paid by the borrower prior to the restructure to set up interest reserves.

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As of June 30, 2018, accruing TDRs were \$84.5 million and non-accrual TDRs were \$30.3 million compared to accruing TDRs of \$68.6 million and non-accrual TDRs of \$33.4 million as of December 31, 2017. The Company allocated specific reserves of \$1.1 million to accruing TDRs and \$71,000 to non-accrual TDRs as of June 30, 2018, and \$1.9 million to accruing TDRs and \$83,000 to non-accrual TDRs as of December 31, 2017. The following tables present TDRs that were modified during the three and six months ended June 30, 2018 and 2017, their specific reserves as of June 30, 2018 and 2017, and charge-offs for the three and six months ended June 30, 2018 and 2017:

| Three months ended June 30, 2018 |                        |                         |                         |                   |       | June 30,<br>2018 |                     |    |   |
|----------------------------------|------------------------|-------------------------|-------------------------|-------------------|-------|------------------|---------------------|----|---|
|                                  | No.<br>of<br>Contracts | Pre-Modification        |                         | Post-Modification |       | Charge-offs      | Specific<br>Reserve |    |   |
|                                  |                        | Outstanding<br>Recorded | Outstanding<br>Recorded |                   |       |                  |                     |    |   |
|                                  |                        | Investment              | Investment              |                   |       |                  |                     |    |   |
|                                  |                        | (Dollars in thousands)  |                         |                   |       |                  |                     |    |   |
| Commercial loans                 | 15                     | \$                      | 5,127                   | \$                | 5,127 | \$               | -                   | \$ | - |
| <b>Total</b>                     | 15                     | \$                      | 5,127                   | \$                | 5,127 | \$               | -                   | \$ | - |

| Three months ended June 30, 2017 |                        |                  |     |                   |     |             | June 30,<br>2017    |    |   |
|----------------------------------|------------------------|------------------|-----|-------------------|-----|-------------|---------------------|----|---|
|                                  | No.<br>of<br>Contracts | Pre-Modification |     | Post-Modification |     | Charge-offs | Specific<br>Reserve |    |   |
|                                  |                        | Outstanding      |     | Outstanding       |     |             |                     |    |   |
|                                  |                        | Recorded         |     | Recorded          |     |             |                     |    |   |
|                                  |                        | Investment       |     | Investment        |     |             |                     |    |   |
| (Dollars in thousands)           |                        |                  |     |                   |     |             |                     |    |   |
| Commercial loans                 | 1                      | \$               | 500 | \$                | 500 | \$          | -                   | \$ | - |
| <b>Total</b>                     | 1                      | \$               | 500 | \$                | 500 | \$          | -                   | \$ | - |

| Six months ended June 30, 2018 |                  |                        |                      |             | June 30, 2018    |
|--------------------------------|------------------|------------------------|----------------------|-------------|------------------|
|                                | No. of Contracts | Pre-Modification       | Post-Modification    | Charge-offs | Specific Reserve |
|                                |                  | Outstanding Recorded   | Outstanding Recorded |             |                  |
|                                |                  | Investment             | Investment           |             |                  |
|                                |                  | (Dollars in thousands) |                      |             |                  |
| Commercial loans               | 18               | \$ 7,590               | \$ 7,590             | \$ -        | \$ -             |

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|                            |    |           |           |      |        |
|----------------------------|----|-----------|-----------|------|--------|
| Commercial mortgage loans  | 6  | 14,287    | 14,287    | -    | 126    |
| Residential mortgage loans | 2  | 801       | 801       | -    | 8      |
| <b>Total</b>               | 26 | \$ 22,678 | \$ 22,678 | \$ - | \$ 134 |

| <b>Six months ended June 30, 2017</b> |   |           |  | <b>June 30, 2017</b> |                         |
|---------------------------------------|---|-----------|--|----------------------|-------------------------|
|                                       | <b>Pre-Modification</b>                             |           | <b>Post-Modification</b>               | <b>Charge-offs</b>   | <b>Specific Reserve</b> |
|                                       | <b>No.</b>  |           |  |                      |                         |
|                                       | <b>of Outstanding Recorded Contracts Investment</b> |           | <b>Outstanding Recorded Investment</b> |                      |                         |
|                                       | <b>(Dollars in thousands)</b>                       |           |  |                      |                         |
| Commercial loans                      | 1   | \$ 500    | \$ 500                                 | \$ -                 | \$ -                    |
| Real estate construction loans        | 2   | 27,683    | 27,683                                 | -                    | \$ -                    |
| <b>Total</b>                          | 3   | \$ 28,183 | \$ 28,183                              | \$ -                 | \$ -                    |

Modifications of the loan terms during the first six months of 2018 were in the form of extensions of maturity dates, which ranged from three to twelve months from the modification date.

We expect that the TDRs on accruing status as of June 30, 2018, which were all performing in accordance with their restructured terms, will continue to comply with the restructured terms because of the reduced principal or interest payments on these loans. A summary of TDRs by type of concession and by type of loan, as of June 30, 2018, and December 31, 2017, is shown below:

| <b>June 30, 2018</b>       |                           |          |                              |              |
|----------------------------|---------------------------|----------|------------------------------|--------------|
| <b>Accruing TDRs</b>       | <b>Payment Rate</b>       |          | <b>Rate</b>                  | <b>Total</b> |
|                            | <b>Deferral Reduction</b> |          | <b>Reduction and Payment</b> |              |
|                            |                           |          | <b>Deferral</b>              |              |
|                            | <b>(In thousands)</b>     |          |                              |              |
| Commercial loans           | \$33,528                  | \$ -     | \$ -                         | \$33,528     |
| Commercial mortgage loans  | 17,610                    | 7,474    | 19,715                       | 44,799       |
| Residential mortgage loans | 3,110                     | 330      | 2,720                        | 6,160        |
| Total accruing TDRs        | \$54,248                  | \$ 7,804 | \$ 22,435                    | \$84,487     |





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| <b>Non-accrual TDRs</b>    | <b>Payment<br/>Deferral</b> | <b>Rate<br/>Reduction<br/>and<br/>Payment<br/>Deferral</b> | <b>Total</b> |
|----------------------------|-----------------------------|--|--------------|
|                            | <b>(In thousands)</b>       |  |              |
| Commercial loans           | \$13,721                    | \$ -   | \$13,721     |
| Commercial mortgage loans  | 3,936                       | 10,462   | 14,398       |
| Residential mortgage loans | 2,110                       | 118  | 2,228        |
| Total non-accrual TDRs     | \$19,767                    | \$ 10,580  | \$30,347     |

**December 31, 2017**

| <b>Accruing TDRs</b>       | <b>Payment<br/>Deferral</b> | <b>Rate<br/>Reduction</b> | <b>Rate<br/>Reduction<br/>and<br/>Payment<br/>Deferral</b> | <b>Total</b> |
|----------------------------|-----------------------------|---------------------------|--|--------------|
|                            | <b>(In thousands)</b>       |                           |  |              |
| Commercial loans           | \$29,199                    | \$ -                      | \$ -   | \$29,199     |
| Commercial mortgage loans  | 11,504                      | 5,871                     | 15,468   | 32,843       |
| Residential mortgage loans | 3,416                       | 335                       | 2,772  | 6,523        |
| Total accruing TDRs        | \$44,119                    | \$ 6,206                  | \$ 18,240  | \$68,565     |

**December 31, 2017**

| <b>Non-accrual TDRs</b> | <b>Payment<br/>Deferral</b> | <b>Rate<br/>Reduction</b> | <b>Rate<br/>Reduction<br/>and<br/>Payment<br/>Deferral</b> | <b>Total</b> |
|-------------------------|-----------------------------|---------------------------|--|--------------|
|                         | <b>(In thousands)</b>       |                           |  |              |
| Commercial loans        | \$12,944                    | \$ -                      | \$ -   | \$12,944     |

|                            |          |          |           |          |
|----------------------------|----------|----------|-----------|----------|
| Commercial mortgage loans  | 6,231    | 1,677    | 11,113    | 19,021   |
| Residential mortgage loans | 1,297    | -        | 154       | 1,451    |
| Total non-accrual TDRs     | \$20,472 | \$ 1,677 | \$ 11,267 | \$33,416 |

The activity within our TDRs for the periods indicated is shown below:

| <b>Accruing TDRs</b>                            | <b>Three months ended June 30,</b> |             | <b>Six months ended June 30,</b> |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | <b>2018</b>                        | <b>2017</b> | <b>2018</b>                      | <b>2017</b> |
|   | <b>(In thousands)</b>              |             |                                  |             |
| Beginning balance                               | \$82,785                           | \$80,419    | \$68,566                         | \$65,393    |
| New restructurings                              | 5,127                              | 500         | 22,447                           | 28,183      |
| Restructured loans restored to accrual status   | -                                  | -           | 2,318                            | -           |
| Payments  | (2,855 )                           | (1,100 )    | (6,746 )                         | (5,695 )    |
| Restructured loans placed on non-accrual status | (570 )                             | -           | (2,098 )                         | (5,822 )    |
| Expiration of loan concession upon renewal      | -                                  | -           | -                                | (2,240 )    |
| Ending balance                                  | \$84,487                           | \$79,819    | \$84,487                         | \$79,819    |

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| <b>Non-accrual TDRs</b>                         | <b>Three months ended June 30,</b> |             | <b>Six months ended June 30,</b> |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | <b>2018</b>                        | <b>2017</b> | <b>2018</b>                      | <b>2017</b> |
|   | <b>(In thousands)</b>              |             |                                  |             |
| Beginning balance                               | \$31,195                           | \$32,779    | \$33,415                         | \$29,722    |
| New restructurings                              | -                                  | -           | 231                              | -           |
| Restructured loans placed on non-accrual status | 570                                | -           | 2,098                            | 5,822       |
| Charge-offs                                     | (161 )                             | (497 )      | (161 )                           | (1,546 )    |
| Payments  | (1,257 )                           | (2,237 )    | (2,918 )                         | (3,227 )    |
| Foreclosures                                    | -                                  | -           | -                                | (726 )      |
| Restructured loans restored to accrual status   | -                                  | -           | (2,318 )                         | -           |
| Ending balance                                  | \$30,347                           | \$30,045    | \$30,347                         | \$30,045    |

The Company considers a loan to be in payment default once it is 60 to 90 days contractually past due under the modified terms. The Company did not have any loans that were modified as a TDR during the previous twelve months and which had subsequently defaulted as of June 30, 2018.

Under the Company's internal underwriting policy, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification in order to determine whether a borrower is experiencing financial difficulty.

As of June 30, 2018, there were no commitments to lend additional funds to those borrowers whose loans had been restructured, were considered impaired, or were on non-accrual status.

As part of the on-going monitoring of the credit quality of our loan portfolio, the Company utilizes a risk grading matrix to assign a risk grade to each loan. The risk rating categories can be generally described by the following grouping for non-homogeneous loans:

**Pass/Watch** – These loans range from minimal credit risk to lower than average, but still acceptable, credit risk.

**Special Mention** – Borrower is fundamentally sound and loan is currently protected but adverse trends are apparent that, if not corrected, may affect ability to repay. Primary source of loan repayment remains viable but there is increasing reliance on collateral or guarantor support.

**Substandard** – These loans are inadequately protected by current sound net worth, paying capacity, or collateral. Well-defined weaknesses exist that could jeopardize repayment of debt. Loss may not be imminent, but if weaknesses are not corrected, there is a good possibility of some loss.

**Doubtful** – The possibility of loss is extremely high, but due to identifiable and important pending events (which may strengthen the loan), a loss classification is deferred until the situation is better defined.

**Loss** – These loans are considered uncollectible and of such little value that to continue to carry the loan as an active asset is no longer warranted.

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The following tables present the loan portfolio by risk rating as of June 30, 2018, and as of December 31, 2017:

|   | <b>June 30, 2018</b>  |                            |                    |                 |              |
|---|-----------------------|----------------------------|--------------------|-----------------|--------------|
|   | <b>Pass/Watch</b>     | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Total</b> |
|   | <b>(In thousands)</b> |                            |                    |                 |              |
| Commercial loans                            | \$2,374,736           | \$117,809                  | \$84,104           | \$-             | \$2,576,649  |
| Real estate construction loans              | 527,600               | 46,277                     | 8,040              | -               | 581,917      |
| Commercial mortgage loans                   | 6,193,626             | 312,503                    | 109,662            | -               | 6,615,791    |
| Residential mortgage loans and equity lines | 3,557,644             | -                          | 12,676             | -               | 3,570,320    |
| Installment and other loans                 | 4,060                 | -                          | -                  | -               | 4,060        |
| Total gross loans                           | \$12,657,666          | \$476,589                  | \$214,482          | \$-             | \$13,348,737 |
| Loans held for sale                         | \$-                   | \$-                        | \$-                | \$-             | \$-          |

|   | <b>December 31, 2017</b> |                            |                    |                 |              |
|---|--------------------------|----------------------------|--------------------|-----------------|--------------|
|   | <b>Pass/Watch</b>        | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Total</b> |
|   | <b>(In thousands)</b>    |                            |                    |                 |              |
| Commercial loans                            | \$2,281,698              | \$118,056                  | \$61,503           | \$9             | \$2,461,266  |
| Real estate construction loans              | 616,411                  | 54,209                     | 8,185              | -               | 678,805      |
| Commercial mortgage loans                   | 6,004,258                | 308,924                    | 169,513            | -               | 6,482,695    |
| Residential mortgage loans and equity lines | 3,232,606                | -                          | 9,748              | -               | 3,242,354    |
| Installment and other loans                 | 5,170                    | -                          | -                  | -               | 5,170        |
| Total gross loans                           | \$12,140,143             | \$481,189                  | \$248,949          | \$9             | \$12,870,290 |
| Loans held for sale                         | \$-                      | \$-                        | \$8,000            | \$-             | \$8,000      |

The following table presents the balance in the allowance for loan losses by portfolio segment and based on impairment method as of June 30, 2018, and as of December 31, 2017:

|  | <b>Real Estate<br/>Commercial Construction<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>Residential<br/>Mortgage<br/>Loans and Equity<br/>Lines</b> | <b>Installment<br/>and<br/>Other<br/>Loans</b> | <b>Total</b> |
|--|--|--|--|--|--------------|
|--|--|--|--|--|--------------|

(In thousands)

**June 30, 2018****Loans individually evaluated for impairment**

|           |          |          |           |           |      |           |
|-----------|----------|----------|-----------|-----------|------|-----------|
| Allowance | \$2,463  | \$ -     | \$ 1,036  | \$ 334    | \$ - | \$3,833   |
| Balance   | \$52,739 | \$ 8,040 | \$ 61,953 | \$ 14,482 | \$ - | \$137,214 |

**Loans collectively evaluated for impairment**

|           |             |            |              |              |          |              |
|-----------|-------------|------------|--------------|--------------|----------|--------------|
| Allowance | \$52,716    | \$ 20,663  | \$ 32,940    | \$ 11,728    | \$ 19    | \$118,066    |
| Balance   | \$2,523,910 | \$ 573,877 | \$ 6,553,838 | \$ 3,555,838 | \$ 4,060 | \$13,211,523 |

|                 |             |            |              |              |          |              |
|-----------------|-------------|------------|--------------|--------------|----------|--------------|
| Total allowance | \$55,179    | \$ 20,663  | \$ 33,976    | \$ 12,062    | \$ 19    | \$121,899    |
| Total balance   | \$2,576,649 | \$ 581,917 | \$ 6,615,791 | \$ 3,570,320 | \$ 4,060 | \$13,348,737 |

**December 31, 2017****Loans individually evaluated for impairment**

|           |          |          |           |           |      |           |
|-----------|----------|----------|-----------|-----------|------|-----------|
| Allowance | \$43     | \$ -     | \$ 1,738  | \$ 353    | \$ - | \$2,134   |
| Balance   | \$43,495 | \$ 8,185 | \$ 52,664 | \$ 13,009 | \$ - | \$117,353 |

**Loans collectively evaluated for impairment**

|           |             |            |              |              |          |              |
|-----------|-------------|------------|--------------|--------------|----------|--------------|
| Allowance | \$49,753    | \$ 24,838  | \$ 35,872    | \$ 10,660    | \$ 22    | \$121,145    |
| Balance   | \$2,417,771 | \$ 670,620 | \$ 6,430,031 | \$ 3,229,345 | \$ 5,170 | \$12,752,937 |

|                 |             |            |              |              |          |              |
|-----------------|-------------|------------|--------------|--------------|----------|--------------|
| Total allowance | \$49,796    | \$ 24,838  | \$ 37,610    | \$ 11,013    | \$ 22    | \$123,279    |
| Total balance   | \$2,461,266 | \$ 678,805 | \$ 6,482,695 | \$ 3,242,354 | \$ 5,170 | \$12,870,290 |

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The following tables detail activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2018, and June 30, 2017. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

**Three months ended June 30, 2018 and 2017**

|   | <b>Commercial</b>     |              | <b>Real Estate</b>  | <b>Commercial</b> | <b>Residential</b> | <b>Installment</b> |              |
|---|-----------------------|--------------|---------------------|-------------------|--------------------|--------------------|--------------|
|   | <b>Loans</b>          | <b>Loans</b> | <b>Construction</b> | <b>Mortgage</b>   | <b>Mortgage</b>    | <b>and</b>         |              |
|   |                       |              |                     |                   | <b>Loans</b>       | <b>Other</b>       | <b>Total</b> |
|   |                       |              |                     |                   | <b>and</b>         |                    |              |
|   |                       |              |                     |                   | <b>Equity</b>      |                    |              |
|   |                       |              |                     |                   | <b>Lines</b>       |                    |              |
|   | <b>(In thousands)</b> |              |                     |                   |                    |                    |              |
| March 31, 2018 Ending Balance                 | \$54,597              | \$ 21,864    |                     | \$ 34,230         | \$ 11,372          | \$ 21              | 122,084      |
| Provision/(credit) for possible credit losses | 920                   | (1,245 )     |                     | (533 )            | 860                | (2 )               | -            |
| Charge-offs                                   | (488 )                | -            |                     | (161 )            | (229 )             | -                  | (878 )       |
| Recoveries                                    | 150                   | 44           |                     | 440               | 59                 | -                  | 693          |
| Net (charge-offs)/recoveries                  | (338 )                | 44           |                     | 279               | (170 )             | -                  | (185 )       |
| June 30, 2018 Ending Balance                  | \$55,179              | \$ 20,663    |                     | \$ 33,976         | \$ 12,062          | \$ 19              | \$121,899    |
| March 31, 2017 Ending Balance                 | \$47,276              | \$ 19,768    |                     | \$ 35,960         | \$ 12,526          | \$ 14              | \$115,544    |
| Provision/(credit) for possible credit losses | (340 )                | (1,971 )     |                     | 477               | 1,831              | 3                  | -            |
| Charge-offs                                   | (527 )                | -            |                     | -                 | -                  | -                  | (527 )       |
| Recoveries                                    | 335                   | 47           |                     | 403               | 7                  | -                  | 792          |
| Net (charge-offs)/recoveries                  | (192 )                | 47           |                     | 403               | 7                  | -                  | 265          |
| June 30, 2017 Ending Balance                  | \$46,744              | \$ 17,844    |                     | \$ 36,840         | \$ 14,364          | \$ 17              | \$115,809    |

**Six months ended June 30, 2018 and 2017**

|   | <b>Commercial</b>     |              | <b>Real Estate</b>  | <b>Commercial</b> | <b>Residential</b> | <b>Installment</b> |              |
|---|-----------------------|--------------|---------------------|-------------------|--------------------|--------------------|--------------|
|   | <b>Loans</b>          | <b>Loans</b> | <b>Construction</b> | <b>Mortgage</b>   | <b>Mortgage</b>    | <b>and</b>         |              |
|   |                       |              |                     |                   | <b>Loans</b>       | <b>Other</b>       | <b>Total</b> |
|   |                       |              |                     |                   | <b>and</b>         |                    |              |
|   |                       |              |                     |                   | <b>Equity</b>      |                    |              |
|   |                       |              |                     |                   | <b>Lines</b>       |                    |              |
|   | <b>(In thousands)</b> |              |                     |                   |                    |                    |              |
| 2018 Beginning Balance                        | \$49,796              | \$ 24,838    |                     | \$ 37,610         | \$ 11,013          | \$ 22              | \$123,279    |
| Provision/(credit) for possible credit losses | 4,827                 | (4,263 )     |                     | (4,696 )          | 1,135              | (3 )               | (3,000 )     |

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|  |          |           |           |           |       |           |
|--|----------|-----------|-----------|-----------|-------|-----------|
| Charge-offs                                      | (507 )   | -         | (161 )    | (229 )    | -     | (897 )    |
| Recoveries                                       | 1,063    | 88        | 1,223     | 143       | -     | 2,517     |
| Net recoveries                                   | 556      | 88        | 1,062     | (86 )     | -     | 1,620     |
| June 30, 2018 Ending Balance                     | \$55,179 | \$ 20,663 | \$ 33,976 | \$ 12,062 | \$ 19 | \$121,899 |
| Reserve for impaired loans                       | \$2,463  | \$ -      | \$ 1,036  | \$ 334    | \$ -  | \$3,833   |
| Reserve for non-impaired loans                   | \$52,716 | \$ 20,663 | \$ 32,940 | \$ 11,728 | \$ 19 | \$118,066 |
| Reserve for off-balance sheet credit commitments | \$1,606  | \$ 1,207  | \$ 77     | \$ 190    | \$ 8  | \$3,088   |
| 2017 Beginning Balance                           | \$49,203 | \$ 23,268 | \$ 34,864 | \$ 11,620 | \$ 11 | \$118,966 |
| (Credit)/provision for possible credit losses    | (1,556 ) | (5,520 )  | 1,840     | 2,729     | 7     | (2,500 )  |
| Charge-offs                                      | (1,730 ) | -         | (555 )    | -         | -     | (2,285 )  |
| Recoveries                                       | 826      | 96        | 691       | 15        | -     | 1,628     |
| Net (charge-offs)/recoveries                     | (904 )   | 96        | 136       | 15        | -     | (657 )    |
| June 30, 2017 Ending Balance                     | \$46,743 | \$ 17,844 | \$ 36,840 | \$ 14,364 | \$ 18 | \$115,809 |
| Reserve for impaired loans                       | \$144    | -         | \$ 1,019  | \$ 398    | -     | \$1,561   |
| Reserve for non-impaired loans                   | \$46,599 | \$ 17,844 | \$ 35,821 | \$ 13,966 | \$ 18 | \$114,248 |
| Reserve for off-balance sheet credit commitments | \$2,583  | \$ 1,707  | \$ 74     | \$ 143    | \$ 6  | \$4,513   |



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**9. Commitments and Contingencies**

The Company is involved in various litigation concerning transactions entered into in the normal course of business. Management, after consultation with legal counsel, does not believe that the resolution of such litigation will have a material effect upon its consolidated financial condition, results of operations, or liquidity taken as a whole. Although the Company establishes accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a loss is probable and that the amount of loss can be reasonably estimated, the Company does not have accruals for all legal proceedings where there is a risk of loss. In addition, amounts accrued may not represent the ultimate losses to the Company from the legal proceedings in question. Thus, ultimate losses may be higher or lower, and possibly significantly so, than the amounts accrued for legal loss contingencies.

In the normal course of business, the Company becomes a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans, or through commercial or standby letters of credit and financial guarantees. These instruments represent varying degrees of exposure to risk in excess of the amounts included in the accompanying condensed consolidated balance sheets. The contractual or notional amount of these instruments indicates a level of activity associated with a particular class of financial instrument and is not a reflection of the level of expected losses, if any.

**10. Borrowed Funds**

*Securities Sold Under Agreements to Repurchase.* Securities sold under agreements to repurchase were \$50 million with a weighted average rate of 2.98% as of June 30, 2018, compared to \$100 million with a weighted average rate of 2.86% as of December 31, 2017. Final maturity for the fixed rate non-callable securities sold under agreements to repurchase was \$50.0 million in July 2018.

These transactions are accounted for as collateralized financing transactions and recorded at the amounts at which the securities were sold. The Company may have to provide additional collateral for the repurchase agreements, as necessary. The underlying collateral pledged for the repurchase agreements consists of U.S. Treasury securities and mortgage-backed securities with a fair value of \$55.4 million as of June 30, 2018, and \$108.4 million as of December 31, 2017.

*Borrowing from the Federal Home Loan Bank ("FHLB").* As of June 30, 2018, over-night borrowings from the FHLB were \$160 million at a rate of 2.08% compared to \$325 million at a rate of 1.41% as of December 31, 2017. As

of June 30, 2018, the advances from the FHLB were \$320 million at a rate of 1.78% compared to \$105 million at a rate of 1.41% as of December 31, 2017. As of June 30, 2018, FHLB advances of \$245 million will mature in July 2018, \$5 million in October 2018, \$50 million in December 2019, and \$20 million in May 2023.

*Other Borrowing.* Pursuant to the Stock Purchase Agreement with Bank SinoPac Co. Ltd, \$35.2 million of the purchase price were held back at a floating rate of three-month LIBOR rate plus 150 basis points and 50%, 30%, and 20% will be disbursed annually over three years on the anniversary dates, respectively. As of June 30, 2018, the outstanding balance was \$36.0 million with a rate of 2.8% compared to \$35.2 million at December 31, 2017.

*Long-term Debt.* On October 12, 2017, the Bank entered into a term loan agreement of \$75.0 million with U.S. Bank. The loan has a floating rate of one-month LIBOR plus 175 basis points. As of June 30, 2018, the term loan has an interest rate of 3.750% compared to 3.125% at December 31, 2017. The principal amount of the long-term debt from U.S. Bank is due and payable in consecutive quarterly installments of \$4.7 million each on the last day of each calendar quarter commencing December 31, 2018, with the final installment due and payable on October 12, 2020. The U.S. Bank loan proceeds were used to fund a portion of our acquisition of SinoPac Bancorp.

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**11. Income Taxes**

The effective tax rate for the first six months of 2018 was 17.9% compared to 26.4% for the first six months of 2017. The reduction in the effective tax rate was primarily due to the Tax Legislation, which reduced the Company's Federal corporate tax rate from 35% to 21% effective January 1, 2018, an alternative energy investment made in the second quarter and the impact of low income housing tax credits.

As of December 31, 2017, the Company had income tax refunds receivable of \$7.2 million. These income tax receivables are included in other assets in the accompanying condensed consolidated balance sheets.

The Company's tax returns are open for audit by the Internal Revenue Service back to 2014 and by the California Franchise Tax Board back to 2013.

It is reasonably possible that unrecognized tax benefits could change significantly over the next twelve months. The Company does not expect that any such changes would have a material impact on its annual effective tax rate.

**12. Fair Value Measurements**

The Company determined the fair values of our financial instruments based on the following:

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

Level 2 - Observable prices in active markets for similar assets or liabilities; prices for identical or similar assets or liabilities in markets that are not active; directly observable market inputs for substantially the full term of the asset and liability; market inputs that are not directly observable but are derived from or corroborated by observable market data.

Level 3 – Unobservable inputs based on the Company's own judgment about the assumptions that a market participant would use.

The Company uses the following methodologies to measure the fair value of its financial assets and liabilities on a recurring basis:

*Securities Available for Sale.* For certain U.S. Treasury securities, the Company measures the fair value based on quoted market prices in active exchange markets at the reporting date, a Level 1 measurement. The Company also measures securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement. This category generally includes U.S. Government agency securities, state and municipal securities, mortgage-backed securities (“MBS”), commercial MBS, collateralized mortgage obligations, asset-backed securities, corporate bonds and trust preferred securities.

*Warrants.* The Company measures the fair value of warrants based on unobservable inputs based on assumptions and management judgment, a Level 3 measurement.

*Foreign Exchange Contracts.* The Company measures the fair value of foreign exchange contracts based on dealer quotes, a Level 2 measurement.

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*Interest Rate Swaps.* Fair value of interest rate swaps is derived from third party models with observable market data, a Level 2 measurement.

Assets measured at estimated fair value on a non-recurring basis:

Certain assets or liabilities are required to be measured at estimated fair value on a nonrecurring basis subsequent to initial recognition. Generally, these adjustments are the result of lower-of-cost-or-fair value or other impairment write-downs of individual assets. In determining the estimated fair values during the period, the Company determined that substantially all the changes in estimated fair value were due to declines in market conditions versus instrument specific credit risk. For the six months ended June 30, 2018 and December 31, 2017, there were no material adjustments to fair value for the Company's assets and liabilities measured at fair value on a nonrecurring basis in accordance with GAAP.

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The following tables present the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of June 30, 2018, and December 31, 2017:

| June 30, 2018                                    | Fair Value Measurements Using |              |         | Total at     |
|--|-------------------------------|--------------|---------|--------------|
|  | Level 1                       | Level 2      | Level 3 | Fair Value   |
|  | (In thousands)                |              |         |              |
| <b>Assets</b>                                    |                               |              |         |              |
| Debt securities available-for-sale               |                               |              |         |              |
| U.S. Treasury securities                         | \$ 348,544                    | \$-          | \$-     | \$ 348,544   |
| U.S. government agencies                         | -                             | 8,189        | -       | 8,189        |
| U.S. government sponsored entities               | -                             | 383,959      | -       | 383,959      |
| Mortgage-backed securities                       | -                             | 658,288      | -       | 658,288      |
| Collateralized mortgage obligations              | -                             | 1,203        | -       | 1,203        |
| Corporate debt securities                        | -                             | 75,766       | -       | 75,766       |
| Total debt securities available-for-sale         | 348,544                       | 1,127,405    | -       | 1,475,949    |
| Equity securities                                |                               |              |         |              |
| Preferred stock of government sponsored entities | 7,480                         | -            | -       | 7,480        |
| Mutual funds                                     | 6,082                         | -            | -       | 6,082        |
| Other equity securities                          | 9,569                         | -            | -       | 9,569        |
| Total equity securities                          | 23,131                        | -            | -       | 23,131       |
| Warrants   | -                             | -            | 176     | 176          |
| Interest rate swaps                              | -                             | 14,801       | -       | 14,801       |
| Foreign exchange contracts                       | -                             | 389          | -       | 389          |
| Total assets                                     | \$ 371,675                    | \$ 1,142,595 | \$ 176  | \$ 1,514,446 |
| <b>Liabilities</b>                               |                               |              |         |              |
| Option contracts                                 | \$-                           | \$9          | \$-     | \$9          |
| Interest rate swaps                              | -                             | 157          | -       | 157          |
| Foreign exchange contracts                       | -                             | 2,083        | -       | 2,083        |
| Total liabilities                                | \$-                           | \$2,249      | \$-     | \$2,249      |

| <b>December 31, 2017</b> | Fair Value Measurements Using |         |         | Total at Fair Value |
|--------------------------|-------------------------------|---------|---------|---------------------|
|                          | Level 1                       | Level 2 | Level 3 |                     |

(In thousands)

**Assets**

## Securities available-for-sale

|  |            |              |       |              |
|--|------------|--------------|-------|--------------|
| U.S. Treasury securities                         | \$ 249,520 | \$ -         | \$ -  | \$ 249,520   |
| U.S. government agency entities                  | -          | 8,988        | -     | 8,988        |
| U.S. government sponsored entities               | -          | 390,336      | -     | 390,336      |
| State and municipal securities                   | -          | 1,914        | -     | 1,914        |
| Mortgage-backed securities                       | -          | 571,969      | -     | 571,969      |
| Collateralized mortgage obligations              | -          | 1,516        | -     | 1,516        |
| Corporate debt securities                        | -          | 81,281       | -     | 81,281       |
| Mutual funds                                     | 6,230      | -            | -     | 6,230        |
| Preferred stock of government sponsored entities | 10,102     | -            | -     | 10,102       |
| Other equity securities                          | 11,770     | -            | -     | 11,770       |
| Total securities available-for-sale              | 277,622    | 1,056,004    | -     | 1,333,626    |
| Warrants   | -          | -            | 91    | 91           |
| Interest rate swaps                              | -          | 5,218        | -     | 5,218        |
| Foreign exchange contracts                       | -          | 1,832        | -     | 1,832        |
| Total assets                                     | \$ 277,622 | \$ 1,063,054 | \$ 91 | \$ 1,340,767 |

**Liabilities**

|                            |      |          |      |          |
|----------------------------|------|----------|------|----------|
| Option contracts           | \$ - | \$ 9     | \$ - | \$ 9     |
| Interest rate swaps        | -    | 2,699    | -    | 2,699    |
| Foreign exchange contracts | -    | 453      | -    | 453      |
| Total liabilities          | \$ - | \$ 3,161 | \$ - | \$ 3,161 |

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The Company measured the fair value of its warrants on a recurring basis using significant unobservable inputs. The fair value of warrants was \$176,000 as of June 30, 2018, compared to \$91,000 as of December 31, 2017. The fair value adjustment of warrants was included in other operating income in the second quarter of 2018. The significant unobservable inputs in the Black-Scholes option pricing model for the fair value of warrants are their expected life ranging from 1 to 6 years, risk-free interest rate from 2.48% to 3.12%, and stock volatility from 8.19% to 12.80%.

For financial assets measured at fair value on a nonrecurring basis that were still reflected in the condensed consolidated balance sheet as of June 30, 2018, the following tables provide the level of valuation assumptions used to determine each adjustment, the carrying value of the related individual assets as of June 30, 2018, and December 31, 2017, and the total gains and losses for the periods indicated:

|  | As of June 30, 2018           |         |          |          | Total (Gains)/Losses       |               |                          |               |
|--|-------------------------------|---------|----------|----------|----------------------------|---------------|--------------------------|---------------|
|  | Fair Value Measurements Using |         |          | Total at | For the Three Months Ended |               | For the Six Months Ended |               |
|  | Level 1                       | Level 2 | Level 3  |          | Fair Value                 | June 30, 2018 | June 30, 2017            | June 30, 2018 |
|  | (In thousands)                |         |          |          |                            |               |                          |               |
| <b>Assets</b>  |                               |         |          |          |                            |               |                          |               |
| Impaired loans by type:                                  |                               |         |          |          |                            |               |                          |               |
| Commercial loans   | \$-                           | \$-     | \$755    | \$755    | \$-                        | \$497         | \$-                      | \$1,273       |
| Commercial mortgage loans                                | -                             | -       | 26,409   | 26,409   | -                          | -             | -                        | 250           |
| Residential mortgage loans and equity lines              | -                             | -       | 7,605    | 7,605    | -                          | -             | -                        | -             |
| Total impaired loans                                     | -                             | -       | 34,769   | 34,769   | -                          | 497           | -                        | 1,523         |
| Other real estate owned <sup>(1)</sup>                   | -                             | 4,363   | 4,343    | 8,706    | (33)                       | 212           | -                        | 249           |
| Investments in venture capital and private company stock | -                             | -       | 2,383    | 2,383    | 91                         | 166           | 264                      | 352           |
| Total assets   | \$-                           | \$4,363 | \$41,495 | \$45,858 | \$58                       | \$875         | \$264                    | \$2,124       |

(1) Other real estate owned balance of \$8.2 million in the condensed consolidated balance sheet is net of estimated disposal costs.

| As of December 31, 2017 |  | Total at | Total Losses For the Twelve Months Ended |
|-------------------------|--|----------|--|
| Fair Value Measurements |  |          |  |



## Using

| Level 1 | Level 2 | Level 3 | Fair Value | December 31, 2017 | December 31, 2016 |
|---------|---------|---------|------------|-------------------|-------------------|
|---------|---------|---------|------------|-------------------|-------------------|

(In thousands)

**Assets**

Impaired loans by type:

|  |     |         |          |          |       |          |
|--|-----|---------|----------|----------|-------|----------|
| Commercial loans   | \$- | \$-     | \$18,097 | \$18,097 | \$25  | \$ 322   |
| Commercial mortgage loans                                | -   | -       | 31,459   | 31,459   | -     | -        |
| Residential mortgage loans and equity lines              | -   | -       | 11,355   | 11,355   | -     | -        |
| Total impaired loans                                     | -   | -       | 60,911   | 60,911   | 25    | 322      |
| Other real estate owned <sup>(1)</sup>                   | -   | 5,677   | 4,322    | 9,999    | 457   | 9        |
| Investments in venture capital and private company stock | -   | -       | 2,583    | 2,583    | 392   | 976      |
| <b>Total assets</b>                                      | \$- | \$5,677 | \$67,816 | \$73,493 | \$874 | \$ 1,307 |

(1) Other real estate owned balance of \$9.4 million in the Consolidated Balance Sheets is net of estimated disposal costs.

The significant unobservable (Level 3) inputs used in the fair value measurement of collateral for collateral-dependent impaired loans was primarily based on the appraised value of collateral adjusted by estimated sales cost and commissions. The Company generally obtains new appraisal reports every twelve months. As the Company's primary objective in the event of default would be to monetize the collateral to settle the outstanding balance of the loan, less marketable collateral would receive a larger discount. During the reported periods, collateral discounts ranged from 55% in the case of accounts receivable collateral to 65% in the case of inventory collateral.

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The significant unobservable inputs used in the fair value measurement of loans held for sale was primarily based on the quoted price or sale price adjusted by estimated sales cost and commissions.

The significant unobservable inputs used in the fair value measurement of other real estate owned (“OREO”) was primarily based on the appraised value of OREO adjusted by estimated sales cost and commissions. The Company applies estimated sales cost and commissions ranging from 3% to 6% of the collateral value of impaired loans, quoted price, or loan sale price of loans held for sale, and appraised value of OREO.

**13. Fair Value of Financial Instruments**

The Company uses the following methods and assumptions to estimate the fair value of each class of financial instruments.

*Cash and Cash Equivalents.* For cash and cash equivalents, the carrying amount was assumed to be a reasonable estimate of fair value, a Level 1 measurement.

*Short-term Investments and interest bearing deposits.* For short-term investments and interest bearing deposits, the carrying amount was assumed to be a reasonable estimate of fair value, a Level 1 measurement.

*Securities Purchased under Agreements to Resell.* The fair value of securities purchased under agreements to resell is based on dealer quotes, a Level 2 measurement.

*Securities.* For securities, including securities held-to-maturity, available-for-sale, and for trading, fair values were based on quoted market prices at the reporting date. If a quoted market price was not available, fair value was estimated using quoted market prices for similar securities or dealer quotes. For certain actively traded agency preferred stock, U.S. Treasury securities, and other equity securities, the Company measures the fair value based on quoted market prices in active exchange markets at the reporting date, a Level 1 measurement. The Company also measures securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement. This category generally includes U.S. Government agency securities, state and municipal securities, mortgage-backed securities (“MBS”), commercial MBS, collateralized mortgage obligations, asset-backed securities, and corporate bonds.

*Loans Held for Sale.* The Company records loans held for sale at fair value based on quoted prices from third party sources, or appraisal reports adjusted by sales commission assumptions.

*Loans.* Fair values were estimated for portfolios of loans with similar financial characteristics. Each loan category was further segmented into fixed and adjustable rate interest terms and by performing and non-performing categories. The fair values were based primarily on third-party vendor pricing to determine fair values based on the exit price notion.

The fair value of performing loans was calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan, a Level 3 measurement.

The fair value of impaired loans was calculated based on the net realizable fair value of the collateral or the observable market price of the most recent sale or quoted price from loans held for sale. The Company does not record loans at fair value on a recurring basis. Nonrecurring fair value adjustments to collateral dependent impaired loans are recorded based on the current appraised value or adjusted appraised value of the collateral, a Level 2 or Level 3 measurement.

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*FHLB Stock.* These securities can only be redeemed or sold at their par value and only to the respective issuing government-supported institution or to another member institution. Management considers these non-marketable equity securities to be long-term investments. Accordingly, when evaluating these securities for impairment, management considers the ultimate recoverability of the par value rather than recognizing temporary declines in value.

*Deposit Liabilities.* The fair value of demand deposits, savings accounts, and certain money market deposits was assumed to be the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit was estimated using the rates currently offered for deposits with similar remaining maturities, a Level 3 measurement.

*Securities Sold under Agreements to Repurchase.* The fair value of securities sold under agreements to repurchase is based on dealer quotes, a Level 2 measurement.

*Advances from FHLB.* The fair value of the advances is based on quotes from the FHLB to settle the advances, a Level 2 measurement.

*Other Borrowings.* This category includes borrowings from other financial institutions. The fair value of other borrowings is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk, a Level 3 measurement.

*Long-term Debt.* The fair value of long-term debt is estimated based on the quoted market prices or dealer quotes, a Level 2 measurement.

*Currency Option and Foreign Exchange Contracts.* The Company measures the fair value of currency option and foreign exchange contracts based on dealer quotes, a Level 2 measurement.

*Interest Rate Swaps.* Fair value of interest rate swaps is derived from third party models with observable market data, a Level 2 measurement.

*Off-Balance-Sheet Financial Instruments.* The fair value of commitments to extend credit, standby letters of credit, and financial guarantees written were estimated using the fees currently charged to enter into similar agreements,

taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The fair value of guarantees and letters of credit was based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. The fair value of off-balance-sheet financial instruments was based on the assumptions that a market participant would use, a Level 3 measurement.

Fair value was estimated in accordance with ASC Topic 825. Fair value estimates were made at specific points in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates were based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates were subjective in nature and involved uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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The following table presents the carrying and notional amounts and estimated fair value of financial instruments as of June 30, 2018, and as of December 31, 2017:

|  | June 30, 2018      |            | December 31, 2017  |            |
|--|--------------------|------------|--------------------|------------|
|  | Carrying<br>Amount | Fair Value | Carrying<br>Amount | Fair Value |
|  | (In thousands)     |            |                    |            |
| <b>Financial Assets</b>                              |                    |            |                    |            |
| Cash and due from banks                              | \$ 195,392         | \$ 195,392 | \$ 247,056         | \$ 247,056 |
| Short-term investments and interest bearing deposits | 208,749            | 208,749    | 292,745            | 292,745    |
| Securities available-for-sale                        | 1,475,949          | 1,475,949  | 1,333,626          | 1,333,626  |
| Equity securities                                    | 23,131             | 23,131     | -                  | -          |
| Loans held for sale                                  | -                  | -          | 8,000              | 8,000      |
| Loans, net <sup>(1)</sup>                            | 13,223,590         | 13,190,937 | 12,743,766         | 12,663,049 |
| Investment in Federal Home Loan Bank stock           | 17,250             | 17,250     | 23,085             | 23,085     |
| Warrants   | 176                | 176        | 91                 | 91         |

|                            | <b>Notional</b> |                   | <b>Notional</b> |                   |
|----------------------------|-----------------|-------------------|-----------------|-------------------|
|                            | <b>Amount</b>   | <b>Fair Value</b> | <b>Amount</b>   | <b>Fair Value</b> |
| Foreign exchange contracts | \$62,687        | \$389             | \$108,530       | \$1,832           |
| Interest rate swaps        | 726,879         | 14,801            | 514,159         | 5,218             |

| <b>Financial Liabilities</b>                   | <b>Carrying</b> | <b>Fair Value</b> | <b>Carrying</b> | <b>Fair Value</b> |
|--|-----------------|-------------------|-----------------|-------------------|
|  | <b>Amount</b>   |                   | <b>Amount</b>   |                   |
| Deposits                                       | \$ 13,104,546   | \$ 13,121,255     | \$ 12,689,893   | \$ 12,700,674     |
| Securities sold under agreements to repurchase | 50,000          | 50,041            | 100,000         | 100,163           |
| Advances from Federal Home Loan Bank           | 480,000         | 479,511           | 430,000         | 429,482           |
| Other borrowings                               | 53,397          | 52,276            | 52,885          | 51,075            |
| Long-term debt                                 | 194,136         | 141,473           | 194,136         | 141,865           |

|                            | <b>Notional</b> |                   | <b>Notional</b> |                   |
|----------------------------|-----------------|-------------------|-----------------|-------------------|
|                            | <b>Amount</b>   | <b>Fair Value</b> | <b>Amount</b>   | <b>Fair Value</b> |
| Option contracts           | \$ 1,654        | \$9               | \$1,014         | \$9               |
| Foreign exchange contracts | 92,014          | 2,083             | 32,127          | 453               |
| Interest rate swaps        | 23,655          | 157               | 145,399         | 2,699             |

| <b>Notional</b> | <b>Fair Value</b> | <b>Notional</b> | <b>Fair Value</b> |
|-----------------|-------------------|-----------------|-------------------|
| <b>Amount</b>   |                   | <b>Amount</b>   |                   |

**Off-Balance Sheet Financial Instruments**

|                              |             |           |             |           |
|------------------------------|-------------|-----------|-------------|-----------|
| Commitments to extend credit | \$2,559,651 | \$(2,389) | \$2,366,368 | \$(7,224) |
| Standby letters of credit    | 169,823     | (1,787)   | 140,814     | (1,805)   |
| Other letters of credit      | 35,196      | (28 )     | 27,353      | (52 )     |
| Bill of lading guarantees    | 1,440       | (1 )      | 24          | (0 )      |

(1) In accordance with the prospective adoption of ASU 2016-01, the fair value of loans as of June 30, 2018 was measured using an exit price notion. The fair value of loans as of December 31, 2017 was measured using an entry price notion.

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The following tables present the level in the fair value hierarchy for the estimated fair values of financial instruments as of June 30, 2018, and December 31, 2017.

|  | As of June 30, 2018 |            |           |            |
|--|---------------------|------------|-----------|------------|
|  | Estimated           |            |           |            |
|  | Fair Value          |            |           |            |
|  | Measurement         | Level 1    | Level 2   | Level 3    |
|  | (In thousands)      |            |           |            |
| Financial Assets                                     |                     |            |           |            |
| Cash and due from banks                              | \$ 195,392          | \$ 195,392 | \$ -      | \$ -       |
| Short-term investments and interest bearing deposits | 208,749             | 208,749    | -         | -          |
| Debt securities available-for-sale                   | 1,475,949           | 348,544    | 1,127,405 | -          |
| Equity securities                                    | 23,131              | 23,131     | -         | -          |
| Loans, net <sup>(1)</sup>                            | 13,190,937          | -          | -         | 13,190,937 |
| Investment in Federal Home Loan Bank stock           | 17,250              | -          | 17,250    | -          |
| Warrants   | 176                 | -          | -         | 176        |
| Financial Liabilities                                |                     |            |           |            |
| Deposits   | 13,121,255          | -          | -         | 13,121,255 |
| Securities sold under agreement to repurchase        | 50,041              | -          | 50,041    | -          |
| Advances from Federal Home Loan Bank                 | 479,511             | -          | 479,511   | -          |
| Other borrowings                                     | 52,276              | -          | -         | 52,276     |
| Long-term debt                                       | 141,473             | -          | 141,473   | -          |

|  | As of December 31, 2017 |           |           |            |
|--|-------------------------|-----------|-----------|------------|
|  | Estimated               |           |           |            |
|  | Fair Value              |           |           |            |
|  | Measurement             | Level 1   | Level 2   | Level 3    |
|  | (In thousands)          |           |           |            |
| <b>Financial Assets</b>                              |                         |           |           |            |
| Cash and due from banks                              | \$247,056               | \$247,056 | \$-       | \$-        |
| Short-term investments and interest bearing deposits | 292,745                 | 292,745   | -         | -          |
| Securities available-for-sale                        | 1,333,626               | 277,622   | 1,056,004 | -          |
| Loans held-for-sale                                  | 8,000                   | -         | -         | 8,000      |
| Loans, net <sup>(1)</sup>                            | 12,663,049              | -         | -         | 12,663,049 |
| Investment in Federal Home Loan Bank stock           | 23,085                  | -         | 23,085    | -          |
| Warrants   | 91                      | -         | -         | 91         |
| <b>Financial Liabilities</b>                         |                         |           |           |            |
| Deposits   | 12,700,674              | -         | -         | 12,700,674 |
| Securities sold under agreement to repurchase        | 100,163                 | -         | 100,163   | -          |
| Advances from Federal Home Loan Bank                 | 429,482                 | -         | 429,482   | -          |
| Other borrowings                                     | 51,075                  | -         | -         | 51,075     |
| Long-term debt                                       | 141,865                 | -         | 141,865   | -          |



(1) In accordance with the prospective adoption of ASU 2016-01, the fair value of loans as of June 30, 2018 was measured using an exit price notion. The fair value of loans as of December 31, 2017 was measured using an entry price notion.

#### **14. Goodwill and Goodwill Impairment**

The Company's policy is to assess goodwill for impairment at the reporting unit level on an annual basis or between annual assessments if a triggering event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value.

As of June 30, 2018, the Company's market capitalization was above book value and there was no triggering event that required the Company to assess goodwill for impairment as of an interim date.

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**15. Financial Derivatives**

It is the policy of the Company not to speculate on the future direction of interest rates. However, the Company enters into financial derivatives in order to seek mitigation of exposure to interest rate risks related to our interest-earning assets and interest-bearing liabilities. We believe that these transactions, when properly structured and managed, may provide a hedge against inherent interest rate risk in the Company's assets or liabilities and against risk in specific transactions. In such instances, the Company may enter into interest rate swap contracts or other types of financial derivatives. Prior to considering any hedging activities, we seek to analyze the costs and benefits of the hedge in comparison to other viable alternative strategies. All hedges must be approved by the Bank's Investment Committee.

The Company follows ASC Topic 815 that establishes accounting and reporting standards for financial derivatives, including certain financial derivatives embedded in other contracts, and hedging activities. It requires the recognition of all financial derivatives as assets or liabilities in the Company's consolidated balance sheet and measurement of those financial derivatives at fair value. The accounting treatment of changes in fair value is dependent upon whether or not a financial derivative is designated as a hedge and, if so, the type of hedge. Fair value is determined using third-party models with observable market data. For derivatives designated as cash flow hedges, changes in fair value are recognized in other comprehensive income and are reclassified to earnings when the hedged transaction is reflected in earnings. For derivatives designated as fair value hedges, changes in the fair value of the derivatives are reflected in current earnings, together with changes in the fair value of the related hedged item if there is a highly effective correlation between changes in the fair value of the interest rate swaps and changes in the fair value of the underlying asset or liability that is intended to be hedged. If there is not a highly effective correlation between changes in the fair value of the interest rate swap and changes in the fair value of the underlying asset or liability that is intended to be hedged, then only the changes in the fair value of the interest rate swaps are reflected in the Company's consolidated financial statements.

In May 2014, the Bancorp entered into interest rate swap contracts in the notional amount of \$119.1 million for a period of ten years. The objective of these interest rate swap contracts, which were designated as hedging instruments in cash flow hedges, was to hedge the quarterly interest payments on the Bancorp's \$119.1 million of Junior Subordinated Debentures that had been issued to five trusts, throughout the ten-year period beginning in June 2014 and ending in June 2024, from the risk of variability of these payments resulting from changes in the three-month LIBOR interest rate. The Bancorp pays a weighted average fixed interest rate of 2.61% and receives a variable interest rate of the three-month LIBOR at a weighted average rate of 2.33%. As of June 30, 2018, the notional amount of cash flow interest rate swaps was \$119.1 million and their unrealized gain of \$1.2 million, net of taxes, was included in other comprehensive income compared to unrealized loss of \$2.4 million at June 30, 2017. The amount of periodic net settlement of interest rate swaps included in interest expense was \$123,000 for the three months ended June 30, 2018, compared to \$439,000 for the same quarter a year ago. For the six months ended June 30, 2018, the periodic net settlement of interest rate swaps included in interest expense was \$396,000 compared to \$0.9 million for the same period in 2017. As of June 30, 2018, and 2017, the ineffective portion of these interest rates swaps was not significant.



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As of June 30, 2018, the Bank's outstanding interest rate swap contracts had a notional amount of \$631.4 million for various terms from two to ten years. The Bank entered into these interest rate swap contracts that are matched to individual fixed-rate commercial real estate loans in the Bank's loan portfolio. These contracts have been designated as hedging instruments to hedge the risk of changes in the fair value of the underlying commercial real estate loans due to changes in interest rates. The swap contracts are structured so that the notional amounts reduce over time to match the contractual amortization of the underlying loan and allow prepayments with the same pre-payment penalty amounts as the related loan. The Bank pays a weighted average fixed rate of 4.7% and receives a variable rate of the one-month LIBOR rate plus a weighted average spread of 271 basis points, or at a weighted average rate of 4.7%. As of June 30, 2018, and June 30, 2017, the notional amount of fair value interest rate swaps was \$631.4 million and \$446.1 million with net unrealized gains of \$13.0 million and \$1.0 million, respectively, included in other non-interest income. The amount of periodic net settlement of interest rate swaps reducing interest income was zero for the three months ended June 30, 2018, compared to \$651,000 for the same period a year ago. The amount of periodic net settlement of interest rate swaps reducing interest income was \$229,000 for the six months ended June 30, 2018, compared to \$1.4 million for the same period a year ago. As of June 30, 2018, and 2017, the ineffective portion of these interest rate swaps was not significant.

Interest rate swap contracts involve the risk of dealing with institutional derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have a strong credit profile and be approved by the Company's Board of Directors. The Company's credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty. Credit exposure may be reduced by the amount of collateral pledged by the counterparty. The Bancorp's interest rate swaps have been assigned by the counterparties to a derivatives clearing organization and daily margin is indirectly maintained with the derivatives clearing organization. Cash posted as collateral by the Bancorp related to derivative contracts totaled \$361,000 as of June 30, 2018 and \$4.5 million as of December 31, 2017.

The Company enters into foreign exchange forward contracts with various counterparties to mitigate the risk of fluctuations in foreign currency exchange rates for foreign exchange certificates of deposit or foreign exchange contracts entered into with our clients. These contracts are not designated as hedging instruments and are recorded at fair value in our consolidated balance sheet. Changes in the fair value of these contracts as well as the related foreign exchange certificates of deposit and foreign exchange contracts are recognized immediately in net income as a component of non-interest income. Period end gross positive fair values are recorded in other assets and gross negative fair values are recorded in other liabilities. At June 30, 2018, the notional amount of option contracts totaled \$1.7 million with a net negative fair value of \$9,000. At June 30, 2018, spot, forward, and swap contracts in the total notional amount of \$62.7 million had a positive fair value of \$389,000. Spot, forward, and swap contracts in the total notional amount of \$92.7 million had a negative fair value of \$2.1 million at June 30, 2018. At December 31, 2017, the notional amount of option contracts totaled \$1.0 million with a net negative fair value of \$9,000. At December 31, 2017, spot, forward, and swap contracts in the total notional amount of \$108.5 million had a positive fair value of \$1.8 million. Spot, forward, and swap contracts in the total notional amount of \$32.1 million had a negative fair value of \$453,000 at December 31, 2017.

Table of Contents**16. Balance Sheet Offsetting**

Certain financial instruments, including resell and repurchase agreements, securities lending arrangements and derivatives, may be eligible for offset in the condensed consolidated balance sheets and/or subject to master netting arrangements or similar agreements. The Company's securities sold with agreements to repurchase and derivative transactions with upstream financial institution counterparties are generally executed under International Swaps and Derivative Association master agreements that include "right of set-off" provisions. In such cases, there is generally a legally enforceable right to offset recognized amounts and there may be an intention to settle such amounts on a net basis. Nonetheless, the Company does not generally offset such financial instruments for financial reporting purposes.

Financial instruments that are eligible for offset in the condensed consolidated balance sheets, as of June 30, 2018, and December 31, 2017, are presented in the following table:

|  |                                |                                      |   |                          |                         |               | Gross Amounts Not<br>Offset in the Balance<br>Sheet |
|--|--------------------------------|--------------------------------------|---|--------------------------|-------------------------|---------------|---|
|  | Gross<br>Amounts<br>Recognized | Offset in<br>the<br>Balance<br>Sheet | Net<br>Amounts<br>Presented<br>in the<br>Balance<br>Sheet | Financial<br>Instruments | Collateral<br>Positions | Net<br>Amount |   |
|  | (In thousands)                 |                                      |   |                          |                         |               |   |
| <b>June 30, 2018</b>                           |                                |                                      |   |                          |                         |               |   |
| <b>Assets:</b>                                 |                                |                                      |   |                          |                         |               |   |
| Derivatives                                    | \$14,801                       | \$ -                                 | \$14,801  | \$-                      | \$-                     | \$14,801      |   |
| <b>Liabilities:</b>                            |                                |                                      |   |                          |                         |               |   |
| Securities sold under agreements to repurchase | \$50,000                       | \$ -                                 | \$50,000  | \$-                      | \$(50,000)              | \$-           |   |
| Derivatives                                    | \$157                          | \$ -                                 | \$157   | \$-                      | \$(157)                 | \$-           |   |
| <b>December 31, 2017</b>                       |                                |                                      |   |                          |                         |               |   |
| <b>Assets:</b>                                 |                                |                                      |   |                          |                         |               |   |
| Derivatives                                    | \$5,218                        | \$ -                                 | \$5,218   | \$-                      | \$-                     | \$5,218       |   |
| <b>Liabilities:</b>                            |                                |                                      |   |                          |                         |               |   |
| Securities sold under agreements to repurchase | \$100,000                      | \$ -                                 | \$100,000   | \$-                      | \$(100,000)             | \$-           |   |
| Derivatives                                    | \$2,699                        | \$ -                                 | \$2,699   | \$-                      | \$(2,699)               | \$-           |   |

**17. Revenue from Contracts with Customers**

On January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers - Topic 606 and all subsequent ASUs that modified ASC 606, Revenue from Contracts with Customers. The Company adopted ASC 606 using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. The new standard did not materially impact the timing or measurement of the Company's revenue recognition as it is consistent with the Company's existing accounting for contracts within the scope of the new standard. There was no cumulative effect adjustment to retained earnings as a result of adopting this new standard.

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The following is a summary of revenue from contracts with customers that are in-scope and not in-scope under Topic 606:

|   | Three months<br>Ended June<br>30,<br>20182017 |         | Six months<br>Ended June 30,<br>20182017 |          |
|---|---|---------|--|----------|
|   | (In thousands)                                |         |  |          |
| Non-interest income, in-scope <sup>(1)</sup> :  |   |         |  |          |
| Fees and service charges on deposit accounts    | \$2,076                                       | \$2,245 | \$4,394                                  | \$4,757  |
| Wealth management fees                          | 1,423   | 574     | 2,724                                    | 1,553    |
| Other service fees <sup>(2)</sup>               | 3,516   | 3,180   | 6,764                                    | 6,349    |
| Total in-scope noninterest income               | 7,015   | 5,999   | 13,882                                   | 12,659   |
| Noninterest income, not in-scope <sup>(3)</sup> | 752   | 153     | (805 )                                   | 211      |
| Total noninterest income                        | \$7,767                                       | \$6,152 | \$13,077                                 | \$12,870 |

- (1) There were no adjustments to the Company's financial statements recorded as a result of the adoption of ASC 606. For comparability, the Company has adjusted prior period amounts to conform to the periods presentation.
- (2) Other service fees comprise of fees related to letters of credit, wire fees, fees on foreign exchange transactions and other immaterial individual revenue streams.
- (3) These amounts primarily represent revenue from contracts with customers that are out of the scope of ASC 606.

The major revenue streams by fee type that are within the scope of ASC 606 presented in the above tables are described in additional detail below:

Fees and Services Charges on Deposit Accounts

Fees and service charges on deposit accounts include charges for analysis, overdraft, cash checking, ATM, and safe deposit activities executed by our deposit clients, as well as interchange income earned through card payment networks for the acceptance of card based transactions. Fees earned from our deposit clients are governed by contracts that provide for overall custody and access to deposited funds and other related services, and can be terminated at will by either party. Fees received from deposit clients for the various deposit activities are recognized as revenue once the performance obligations are met. The adoption of ASU 2014-09 had no impact to the recognition of fees and service charges on deposit accounts.

Wealth Management Fees

The Company employs financial consultants to provide investment planning services for customers including wealth management services, asset allocation strategies, portfolio analysis and monitoring, investment strategies, and risk management strategies. The fees the Company earns are variable and are generally received monthly. The Company recognizes revenue for the services performed at quarter end based on actual transaction details received from the broker dealer the Company engages.

Practical Expedients and Exemptions

The Company applies the practical expedient in ASC 606-10-50-14 and does not disclose the value of unsatisfied performance obligations as the Company's contracts with customers generally have a term that is less than one year, are open-ended with a cancellation period that is less than one year, or allow the Company to recognize revenue in the amount to which the Company has the right to invoice.



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In addition, given the short term nature of the Company's contracts, the Company also applies the practical expedient in ASC 606-10-32-18 and does not adjust the consideration from customers for the effects of a significant financing component, if at contract inception, the period between when the entity transfers the goods or services and when the customer pays for that good or service is one year or less.

**18. Stockholders' Equity**

Total equity was \$2.1 billion as of June 30, 2018, an increase of \$91.5 million, from \$1.97 billion as of December 31, 2017, primarily due to net income of \$137.5 million partially offset by common stock cash dividends of \$39.0 million and decreases in other comprehensive income of \$11.3 million.

The U.S. Treasury received warrants to purchase common stock of 1,846,374 shares at an exercise price of \$20.96 as part of the Company's participation in the U.S. Treasury Troubled Asset Relief Program Capital Purchase Program. As a result of the anti-dilution adjustments under the warrant, the exercise price at December 31, 2017, has been adjusted to \$20.41 and the number of warrants increased by 1.03%. At June 30, 2018, 578,238 warrants remain exercisable compared to 943,327 warrants at December 31, 2017.

Activity in accumulated other comprehensive income, net of tax, and reclassification out of accumulated other comprehensive income for the three months and six months ended June 30, 2018, and June 30, 2017, was as follows:

|  | Three months ended June 30,<br>2018 |                              |              | Three months ended June 30,<br>2017 |                              |             |
|--|-------------------------------------|------------------------------|--------------|-------------------------------------|------------------------------|-------------|
|  | Pre-tax                             | Tax<br>expense/<br>(benefit) | Net-of-tax   | Pre-tax                             | Tax<br>expense/<br>(benefit) | Net-of-tax  |
|  | (In thousands)                      |                              |              |                                     |                              |             |
| <b>Beginning balance, loss, net of tax</b>                     |                                     |                              |              |                                     |                              |             |
| Securities available-for-sale                                  |                                     |                              | \$ (21,333 ) |                                     |                              | \$ (1,771 ) |
| Cash flow hedge derivatives                                    |                                     |                              | 427          |                                     |                              | (1,871 )    |
| Total  |                                     |                              | \$ (20,906 ) |                                     |                              | \$ (3,642 ) |
| <b>Net unrealized (losses)/gains arising during the period</b> |                                     |                              |              |                                     |                              |             |
| Securities available-for-sale                                  | \$ (3,905 )                         | \$ (1,154 )                  | \$ (2,751 )  | \$ 4,786                            | \$ 2,012                     | \$ 2,774    |

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|                             |         |        |          |        |        |        |
|-----------------------------|---------|--------|----------|--------|--------|--------|
| Cash flow hedge derivatives | 1,045   | 309    | 736      | (949 ) | (399 ) | (550 ) |
| Total                       | (2,860) | (845 ) | (2,015 ) | 3,837  | 1,613  | 2,224  |

**Reclassification adjustment for net gains in net income**

|                               |   |   |   |      |      |      |
|-------------------------------|---|---|---|------|------|------|
| Securities available-for-sale | - | - | - | (3 ) | (1 ) | (2 ) |
| Cash flow hedge derivatives   | - | - | - | -    | -    | -    |
| Total                         | - | - | - | (3 ) | (1 ) | (2 ) |

**Total other comprehensive (loss)/income**

|                               |           |          |            |         |         |         |
|-------------------------------|-----------|----------|------------|---------|---------|---------|
| Securities available-for-sale | (3,905)   | (1,154 ) | (2,751 )   | 4,783   | 2,011   | 2,772   |
| Cash flow hedge derivatives   | 1,045     | 309      | 736        | (949 )  | (399 )  | (550 )  |
| Total                         | \$(2,860) | \$(845 ) | \$(2,015 ) | \$3,834 | \$1,612 | \$2,222 |

**Ending balance, (loss)/gain, net of tax**

|                               |  |  |  |              |  |             |
|-------------------------------|--|--|--|--------------|--|-------------|
| Securities available-for-sale |  |  |  | \$ (24,084 ) |  | \$ 1,001    |
| Cash flow hedge derivatives   |  |  |  | 1,163        |  | (2,421 )    |
| Total                         |  |  |  | \$ (22,921 ) |  | \$ (1,420 ) |

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|   | Six months ended June 30, 2018 |                              |              | Six months ended June 30, 2017 |                              |             |
|---|--------------------------------|------------------------------|--------------|--------------------------------|------------------------------|-------------|
|   | Pre-tax                        | Tax<br>expense/<br>(benefit) | Net-of-tax   | Pre-tax                        | Tax<br>expense/<br>(benefit) | Net-of-tax  |
|   | (In thousands)                 |                              |              |                                |                              |             |
| <b>Beginning balance, loss, net of tax</b>  |                                |                              |              |                                |                              |             |
| Securities available-for-sale   |                                |                              | \$ (1,060 )  |                                |                              | \$ (1,545 ) |
| Cash flow hedge derivatives   |                                |                              | (1,451 )     |                                |                              | (2,170 )    |
| Total   |                                |                              | \$ (2,511 )  |                                |                              | \$ (3,715 ) |
| <b>Reclassification adjustment for stranded tax effects of Tax Legislation <sup>(1)</sup></b> |                                |                              |              |                                |                              |             |
| Securities available-for-sale   | -                              | 200                          | (200 )       | -                              | -                            | -           |
| Cash flow hedge derivatives   | -                              | 315                          | (315 )       | -                              | -                            | -           |
| Total   | -                              | 515                          | (515 )       | -                              | -                            | -           |
| <b>Reclassification adjustment for equity securities <sup>(2)</sup></b>                       |                                |                              |              |                                |                              |             |
| Equity securities   | (12,151)                       | (3,592 )                     | (8,559 )     | -                              | -                            | -           |
| <b>Net unrealized (losses)/gains arising during the period</b>                                |                                |                              |              |                                |                              |             |
| Securities available-for-sale   | \$ (20,251)                    | \$ (5,986 )                  | \$ (14,265 ) | \$ 3,930                       | \$ 1,652                     | \$ 2,278    |
| Cash flow hedge derivatives   | 4,158                          | 1,229                        | 2,929        | (433 )                         | (182 )                       | (251 )      |
| Total   | (16,093)                       | (4,757 )                     | (11,336 )    | 3,497                          | 1,470                        | 2,027       |
| <b>Reclassification adjustment for net losses in net income</b>                               |                                |                              |              |                                |                              |             |
| Securities available-for-sale   | -                              | -                            | -            | 463                            | 195                          | 268         |
| Cash flow hedge derivatives   | -                              | -                            | -            | -                              | -                            | -           |
| Total   | -                              | -                            | -            | 463                            | 195                          | 268         |
| <b>Total other comprehensive (loss)/income</b>  |                                |                              |              |                                |                              |             |
| Securities available-for-sale   | (20,251)                       | (5,986 )                     | (14,265 )    | 4,393                          | 1,847                        | 2,546       |
| Cash flow hedge derivatives   | 4,158                          | 1,229                        | 2,929        | (433 )                         | (182 )                       | (251 )      |
| Total   | \$ (16,093)                    | \$ (4,757 )                  | \$ (11,336 ) | \$ 3,960                       | \$ 1,665                     | \$ 2,295    |
| <b>Ending balance, (loss)/gain, net of tax</b>  |                                |                              |              |                                |                              |             |
| Securities available-for-sale   |                                |                              | \$ (24,084 ) |                                |                              | \$ 1,001    |
| Cash flow hedge derivatives   |                                |                              | 1,163        |                                |                              | (2,421 )    |
| Total   |                                |                              | \$ (22,921 ) |                                |                              | \$ (1,420 ) |

(1) These amounts were recorded as of January 1, 2018 as a result of the adoption of ASU 2018-2.

(2) This amount was recorded as of January 1, 2018 as a result of the adoption of ASU 2016-1.

### **19. Stock Repurchase Program**

On February 1, 2016, the Company's Board of Directors approved a new stock repurchase program to buy back up to \$45.0 million of our common stock. The Company did not repurchase any shares under the February 2016 repurchase program in 2017 and for the six months ended June 30, 2018. As of June 30, 2018, and December 31, 2017, the Company may repurchase up to \$7.5 million of its common stock under the February 2016 repurchase program.

### **20. Subsequent Events**

The Company has evaluated the effect of events that have occurred subsequent to June 30, 2018, through the date of issuance of the consolidated financial statements, and there have been no material events that would require recognition in the consolidated financial statements or disclosure in the notes to the consolidated financial statements.

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**Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following discussion is based on the assumption that the reader has access to and has read the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

**Critical Accounting Policies**

The discussion and analysis of the Company’s financial condition and results of operations are based upon its unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues, and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Management of the Company considers the following to be critical accounting policies:

Accounting for the allowance for loan losses involves significant judgments and assumptions by management, which have a material impact on the carrying value of net loans. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances as described in “*Allowance for Credit Losses*” under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

**Highlights**

Total loans increased \$334.2 million, or 10.3% annualized, to \$13.3 billion for the quarter.

Net interest margin for the second quarter increased to 3.83% compared to 3.63% in the second quarter of 2017 and 3.75% in the first quarter of 2018.

Diluted earnings per share increased 40.6% to \$0.90 per share for the second quarter of 2018 compared to \$0.64 per share for the same quarter a year ago.

### **Quarterly Statement of Operations Review**

#### **Net Income**

Net income for the quarter ended June 30, 2018, was \$73.7 million, an increase of \$22.3 million, or 43.4%, compared to net income of \$51.4 million for the same quarter a year ago. Diluted earnings per share for the quarter ended June 30, 2018, was \$0.90 compared to \$0.64 for the same quarter a year ago. Second quarter of 2018 net income included \$1.7 million in acquisition and integration costs related to the FENB acquisition and a \$1.1 million decrease in the fair value of equity securities.

Return on average stockholders' equity was 14.51% and return on average assets was 1.88% for the quarter ended June 30, 2018, compared to a return on average stockholders' equity of 10.96% and a return on average assets of 1.48% for the same quarter a year ago.

Table of Contents**Financial Performance**

|  | Three months ended |               |
|--|--------------------|---------------|
|  | June 30, 2018      | June 30, 2017 |
| Net income (in millions)                     | \$73.7             | \$51.4        |
| Basic earnings per common share              | \$0.91             | \$0.64        |
| Diluted earnings per common share            | \$0.90             | \$0.64        |
| Return on average assets                     | 1.88 %             | 1.48 %        |
| Return on average total stockholders' equity | 14.51 %            | 10.96 %       |
| Efficiency ratio                             | 42.69 %            | 45.88 %       |

**Net Interest Income Before Provision for Credit Losses**

Net interest income before provision for credit losses increased \$22.6 million, or 19.3%, to \$140.0 million during the second quarter of 2018, compared to \$117.4 million during the same quarter a year ago. The increase was due primarily to an increase in interest income from loans and securities, offset by increases in interest expense from time deposits and long-term debt.

The net interest margin was 3.83% for the second quarter of 2018, compared to 3.63% for the second quarter of 2017, and 3.75% for the first quarter of 2018.

For the second quarter of 2018, the yield on average interest-earning assets was 4.58%, the cost of funds on average interest-bearing liabilities was 1.03%, and the cost of interest-bearing deposits was 0.92%. In comparison, for the second quarter of 2017, the yield on average interest-earning assets was 4.19%, the cost of funds on average interest-bearing liabilities was 0.78%, and the cost of interest-bearing deposits was 0.68%. The increase in the yield on average interest earning assets resulted mainly from higher rates on loans. The net interest spread, defined as the difference between the yield on average interest-earning assets and the cost of funds on average interest-bearing liabilities, was 3.55% for the quarter ended June 30, 2018, compared to 3.41% for the same quarter a year ago.

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The following table sets forth information concerning average interest-earning assets, average interest-bearing liabilities, and the average yields and rates paid on those assets and liabilities for the three months ended June 30, 2018, and 2017. Average outstanding amounts included in the table are daily averages.

**Interest-Earning Assets and Interest-Bearing Liabilities**

|  | Three months ended June 30,<br>2018 |                                |                                     |  | 2017               |                                |                                     |
|--|-------------------------------------|--------------------------------|-------------------------------------|--|--------------------|--------------------------------|-------------------------------------|
|  | Average<br>Balance                  | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate<br>(1)(2) |  | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate<br>(1)(2) |
| (Dollars in thousands)                         |                                     |                                |                                     |  |                    |                                |                                     |
| Interest earning assets:                       |                                     |                                |                                     |  |                    |                                |                                     |
| Total loans and leases <sup>(1)</sup>          | \$ 13,020,212                       | \$ 158,659                     | 4.89 %                              |  | \$ 11,388,057      | \$ 129,836                     | 4.57 %                              |
| Investment securities                          | 1,368,718                           | 7,208                          | 2.11                                |  | 1,260,646          | 4,719                          | 1.50                                |
| Federal Home Loan Bank stock                   | 17,489                              | 380                            | 8.73                                |  | 17,250             | 298                            | 6.93                                |
| Interest bearing deposits                      | 274,569                             | 1,273                          | 1.86                                |  | 302,224            | 776                            | 1.03                                |
| Total interest-earning assets                  | 14,680,988                          | 167,520                        | 4.58                                |  | 12,968,177         | 135,629                        | 4.19                                |
| Non-interest earning assets:                   |                                     |                                |                                     |  |                    |                                |                                     |
| Cash and due from banks                        | 203,197                             |                                |                                     |  | 200,765            |                                |                                     |
| Other non-earning assets                       | 988,066                             |                                |                                     |  | 915,151            |                                |                                     |
| Total non-interest earning assets              | 1,191,263                           |                                |                                     |  | 1,115,916          |                                |                                     |
| Less: Allowance for loan losses                | (122,213 )                          |                                |                                     |  | (115,838 )         |                                |                                     |
| Deferred loan fees                             | (3,252 )                            |                                |                                     |  | (4,043 )           |                                |                                     |
| Total assets                                   | \$ 15,746,786                       |                                |                                     |  | \$ 13,964,212      |                                |                                     |
| Interest bearing liabilities:                  |                                     |                                |                                     |  |                    |                                |                                     |
| Interest bearing demand accounts               | \$ 1,381,065                        | \$ 678                         | 0.20                                |  | \$ 1,260,575       | \$ 534                         | 0.17                                |
| Money market accounts                          | 2,201,162                           | 3,744                          | 0.68                                |  | 2,304,586          | 3,774                          | 0.66                                |
| Savings accounts                               | 804,064                             | 410                            | 0.20                                |  | 794,450            | 390                            | 0.20                                |
| Time deposits                                  | 5,848,849                           | 18,730                         | 1.28                                |  | 4,722,920          | 10,769                         | 0.91                                |
| Total interest-bearing deposits                | 10,235,140                          | 23,562                         | 0.92                                |  | 9,082,531          | 15,467                         | 0.68                                |
| Securities sold under agreements to repurchase | 83,517                              | 608                            | 2.92                                |  | 150,000            | 1,065                          | 2.85                                |
| Other borrowings                               | 237,231                             | 1,156                          | 1.95                                |  | 103,538            | 305                            | 1.18                                |
| Long-term debt                                 | 194,136                             | 2,163                          | 4.47                                |  | 119,136            | 1,440                          | 4.86                                |
| Total interest-bearing liabilities             | 10,750,024                          | 27,489                         | 1.03                                |  | 9,455,205          | 18,277                         | 0.78                                |
| Non-interest bearing liabilities:              |                                     |                                |                                     |  |                    |                                |                                     |
| Demand deposits                                | 2,760,643                           |                                |                                     |  | 2,440,181          |                                |                                     |
| Other liabilities                              | 199,445                             |                                |                                     |  | 186,372            |                                |                                     |
| Total equity                                   | 2,036,674                           |                                |                                     |  | 1,882,454          |                                |                                     |
| Total liabilities and equity                   | \$ 15,746,786                       |                                |                                     |  | \$ 13,964,212      |                                |                                     |
| Net interest spread                            |                                     |                                | 3.55 %                              |  |                    |                                | 3.41 %                              |
| Net interest income                            |                                     | \$ 140,031                     |                                     |  |                    | \$ 117,352                     |                                     |
| Net interest margin                            |                                     |                                | 3.83 %                              |  |                    |                                | 3.63 %                              |



- (1) Yields and amounts of interest earned include loan fees. Non-accrual loans are included in the average balance.
- (2) Calculated by dividing net interest income by average outstanding interest-earning assets.

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The following table summarizes the changes in interest income and interest expense attributable to changes in volume and changes in interest rates:

**Taxable-Equivalent Net Interest Income — Changes Due to Volume and Rate<sup>(1)</sup>**

| (In thousands)                                 | Three months ended June 30,<br>2018-2017 |               |                 |
|--|--|---------------|-----------------|
|  | Increase (Decrease) in                   |               |                 |
|  | Net Interest Income Due to:              |               |                 |
|  | Changes<br>in                            | Changes<br>in | Total<br>Change |
|  | Volume                                   | Rate          |                 |
| Interest-earning assets:                       |  |               |                 |
| Loans and leases                               | \$19,474                                 | \$9,350       | \$28,824        |
| Investment securities                          | 433                                      | 2,056         | 2,489           |
| Federal Home Loan Bank stock                   | 4  | 78            | 82              |
| Deposits with other banks                      | (77 )                                    | 574           | 497             |
| Total changes in interest income               | 19,834                                   | 12,058        | 31,892          |
| Interest-bearing liabilities:                  |  |               |                 |
| Interest bearing demand accounts               | 54                                       | 90            | 144             |
| Money market accounts                          | (173 )                                   | 143           | (30 )           |
| Savings accounts                               | 5  | 16            | 21              |
| Time deposits                                  | 2,952                                    | 5,009         | 7,961           |
| Securities sold under agreements to repurchase | (483 )                                   | 26            | (457 )          |
| Other borrowed funds                           | 565                                      | 285           | 850             |
| Long-term debt                                 | 847                                      | (124 )        | 723             |
| Total changes in interest expense              | 3,767                                    | 5,445         | 9,212           |
| Changes in net interest income                 | \$16,067                                 | \$6,613       | \$22,680        |

(1) Changes in interest income and interest expense attributable to changes in both volume and rate have been allocated proportionately to changes due to volume and changes due to rate.

**Provision/(reversal) for credit losses**

There was no reversal for credit losses for the second quarter of 2018 or 2017. The reversal for credit losses was based on a review of the appropriateness of the allowance for loan losses at June 30, 2018. The following table summarizes the charge-offs and recoveries for the periods indicated:

|                                  | Three<br>months<br>ended June<br>30,<br>2018 2017 |         | Six months<br>ended June 30,<br>2018 2017 |         |
|----------------------------------|---|---------|---|---------|
|                                  | (In thousands)                                    |         |   |         |
| Charge-offs:                     |   |         |   |         |
| Commercial loans                 | \$488   | \$527   | \$507                                     | \$1,730 |
| Real estate loans <sup>(1)</sup> | 390   | -       | 390                                       | 555     |
| Total charge-offs                | 878   | 527     | 897                                       | 2,285   |
| Recoveries:                      |   |         |   |         |
| Commercial loans                 | 150   | 335     | 1,063                                     | 826     |
| Construction loans               | 44  | 47      | 88  | 96      |
| Real estate loans <sup>(1)</sup> | 499   | 410     | 1,366                                     | 706     |
| Total recoveries                 | 693   | 792     | 2,517                                     | 1,628   |
| Net (recoveries)/charge-offs     | \$185   | \$(265) | \$(1,620)                                 | \$657   |

(1) Real estate loans include commercial mortgage loans, residential mortgage loans, and equity lines.

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**Non-Interest Income**

Non-interest income, which includes revenues from depository service fees, letters of credit commissions, securities gains (losses), wire transfer fees, and other sources of fee income, was \$7.8 million for the second quarter of 2018, an increase of \$1.6 million, or 25.8%, compared to \$6.2 million for the second quarter of 2017, primarily due to a \$2.7 million increase in other operating income and offset by a \$1.1 million loss from the decrease in the fair value of equity securities during the quarter.

**Non-Interest Expense**

Non-interest expense increased \$6.4 million, or 11.3%, to \$63.1 million in the second quarter of 2018 compared to \$56.7 million in the same quarter a year ago. The increase in non-interest expense in the second quarter of 2018 was primarily due to a \$4.5 million increase in salaries and employee benefits expense, partly from the acquisition of FENB, a \$1.5 million increase in marketing expense, a \$1.7 million increase in acquisition and integration costs offset by a \$2.6 million decrease in provision for unfunded commitments, when compared to the same quarter a year ago. The efficiency ratio was 42.7% in the second quarter of 2018, compared to 45.9% for the same quarter a year ago.

**Income Taxes**

The effective tax rate for the second quarter of 2018 was 13.0% compared to 23.1% for the second quarter of 2017. The effective tax rate includes the reduction of the corporate tax rate from the enactment of the Tax Legislation, an alternative energy investment made in the second quarter and the impact of low income housing tax credits. Income tax expense for 2018 was reduced by \$0.8 million in benefits from the distribution of restricted stock units and exercises of stock options.

**Year-to-Date Statement of Operations Review**

Net income for the six months ended June 30, 2018, was \$137.5 million, an increase of \$37.1 million, or 37.0%, compared to net income of \$100.4 million for the same period a year ago. Diluted earnings per share was \$1.68 compared to \$1.25 per share for the same period a year ago. The net interest margin for the six months ended June 30, 2018, was 3.79% compared to 3.56% for the same period a year ago.

Return on average stockholders' equity was 13.76% and return on average assets was 1.76% for the six months ended June 30, 2018, compared to a return on average stockholders' equity of 10.84% and a return on average assets of 1.45% for the same period a year ago. The efficiency ratio for the six months ended June 30, 2018, was 43.01% compared to 44.79% for the same period a year ago.

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The following table sets forth information concerning average interest-earning assets, average interest-bearing liabilities, and the average yields and rates paid on those assets and liabilities for the six months ended June 30, 2018, and 2017. Average outstanding amounts included in the table are daily averages.

**Interest-Earning Assets and Interest-Bearing Liabilities**

|  | Six months ended June 30,<br>2018 |                                |                                     |  | 2017               |                                |                                     |
|--|-----------------------------------|--------------------------------|-------------------------------------|--|--------------------|--------------------------------|-------------------------------------|
|  | Average<br>Balance                | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate<br>(1)(2) |  | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate<br>(1)(2) |
| (Dollars in thousands)                         |                                   |                                |                                     |  |                    |                                |                                     |
| Interest earning assets:                       |                                   |                                |                                     |  |                    |                                |                                     |
| Total loans and leases <sup>(1)</sup>          | \$ 12,970,484                     | \$ 309,949                     | 4.82 %                              |  | \$ 11,338,983      | \$ 254,746                     | 4.53 %                              |
| Investment securities                          | 1,336,871                         | 13,666                         | 2.06                                |  | 1,247,432          | 9,125                          | 1.48                                |
| Federal Home Loan Bank stock                   | 19,852                            | 776                            | 7.89                                |  | 17,250             | 710                            | 8.30                                |
| Interest bearing deposits                      | 334,465                           | 2,829                          | 1.71                                |  | 393,627            | 1,852                          | 0.95                                |
| Total interest-earning assets                  | 14,661,672                        | 327,220                        | 4.50                                |  | 12,997,292         | 266,433                        | 4.13                                |
| Non-interest earning assets:                   |                                   |                                |                                     |  |                    |                                |                                     |
| Cash and due from banks                        | 215,944                           |                                |                                     |  | 204,920            |                                |                                     |
| Other non-earning assets                       | 976,229                           |                                |                                     |  | 900,470            |                                |                                     |
| Total non-interest earning assets              | 1,192,173                         |                                |                                     |  | 1,105,390          |                                |                                     |
| Less: Allowance for loan losses                | (123,089 )                        |                                |                                     |  | (117,319 )         |                                |                                     |
| Deferred loan fees                             | (3,290 )                          |                                |                                     |  | (4,368 )           |                                |                                     |
| Total assets                                   | \$ 15,727,466                     |                                |                                     |  | \$ 13,980,995      |                                |                                     |
| Interest bearing liabilities:                  |                                   |                                |                                     |  |                    |                                |                                     |
| Interest bearing demand accounts               | \$ 1,393,883                      | \$ 1,308                       | 0.19                                |  | \$ 1,249,050       | \$ 1,051                       | 0.17                                |
| Money market accounts                          | 2,228,446                         | 7,239                          | 0.66                                |  | 2,290,400          | 7,418                          | 0.65                                |
| Savings accounts                               | 821,121                           | 871                            | 0.21                                |  | 754,049            | 675                            | 0.18                                |
| Time deposits                                  | 5,750,722                         | 34,458                         | 1.21                                |  | 4,790,025          | 21,751                         | 0.92                                |
| Total interest-bearing deposits                | 10,194,172                        | 43,876                         | 0.87                                |  | 9,083,524          | 30,895                         | 0.69                                |
| Securities sold under agreements to repurchase | 91,713                            | 1,322                          | 2.91                                |  | 169,613            | 2,615                          | 3.11                                |
| Other borrowings                               | 277,845                           | 2,403                          | 1.74                                |  | 102,547            | 593                            | 1.17                                |
| Long-term debt                                 | 194,136                           | 4,245                          | 4.41                                |  | 119,136            | 2,864                          | 4.85                                |
| Total interest-bearing liabilities             | 10,757,866                        | 51,846                         | 0.97                                |  | 9,474,820          | 36,967                         | 0.79                                |
| Non-interest bearing liabilities:              |                                   |                                |                                     |  |                    |                                |                                     |
| Demand deposits                                | 2,755,754                         |                                |                                     |  | 2,455,587          |                                |                                     |
| Other liabilities                              | 198,938                           |                                |                                     |  | 184,145            |                                |                                     |
| Total equity                                   | 2,014,908                         |                                |                                     |  | 1,866,443          |                                |                                     |
| Total liabilities and equity                   | \$ 15,727,466                     |                                |                                     |  | \$ 13,980,995      |                                |                                     |
| Net interest spread                            |                                   |                                | 3.53 %                              |  |                    |                                | 3.34 %                              |
| Net interest income                            |                                   | \$ 275,374                     |                                     |  |                    | \$ 229,466                     |                                     |
| Net interest margin                            |                                   |                                | 3.79 %                              |  |                    |                                | 3.56 %                              |

- (1) Yields and amounts of interest earned include loan fees. Non-accrual loans are included in the average balance.
- (2) Calculated by dividing net interest income by average outstanding interest-earning assets.

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The following table summarizes the changes in interest income and interest expense attributable to changes in volume and changes in interest rates:

**Taxable-Equivalent Net Interest Income — Changes Due to Volume and Rate<sup>(1)</sup>**

| (In thousands)                                 | Six months ended June 30,<br>2018-2017 |               |                 |
|--|--|---------------|-----------------|
|  | Increase (Decrease) in                 |               |                 |
|  | Net Interest Income Due to:            |               |                 |
|  | Changes<br>in                          | Changes<br>in | Total<br>Change |
|  | Volume                                 | Rate          |                 |
| Interest-earning assets:                       |  |               |                 |
| Loans and leases                               | \$38,272                               | \$16,931      | \$55,203        |
| Investment securities                          | 694                                    | 3,847         | 4,541           |
| Federal Home Loan Bank stock                   | 103                                    | (37 )         | 66              |
| Deposits with other banks                      | (317 )                                 | 1,294         | 977             |
| Total changes in interest income               | 38,752                                 | 22,035        | 60,787          |
| Interest-bearing liabilities:                  |  |               |                 |
| Interest bearing demand accounts               | 129                                    | 128           | 257             |
| Money market accounts                          | (202 )                                 | 23            | (179 )          |
| Savings accounts                               | 64                                     | 132           | 196             |
| Time deposits                                  | 4,900                                  | 7,807         | 12,707          |
| Securities sold under agreements to repurchase | (1,133 )                               | (160 )        | (1,293 )        |
| Other borrowed funds                           | 1,403                                  | 407           | 1,810           |
| Long-term debt                                 | 1,664                                  | (283 )        | 1,381           |
| Total changes in interest expense              | 6,825                                  | 8,054         | 14,879          |
| Changes in net interest income                 | \$31,927                               | \$13,981      | \$45,908        |

(1) Changes in interest income and interest expense attributable to changes in both volume and rate have been allocated proportionately to changes due to volume and changes due to rate.

Balance Sheet Review



## **Assets**

Total assets were \$16.2 billion as of June 30, 2018, an increase of \$557.6 million, or 3.6%, from \$15.6 billion as of December 31, 2017, primarily due to loan growth and increases in investment securities offset by decreases in short-term investments.

## **Investment Securities**

Investment securities represented 9.1% of total assets as of June 30, 2018, compared to 8.5% of total assets as of December 31, 2017. Securities available-for-sale were \$1.5 billion as of June 30, 2018, compared to \$1.3 billion as of December 31, 2017.

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The following tables reflect the amortized cost, gross unrealized gains, gross unrealized losses, and fair value of securities available-for-sale as of June 30, 2018, and investment securities as of December 31, 2017:

|                                     | June 30, 2018  |            |            |             |
|-------------------------------------|----------------|------------|------------|-------------|
|                                     | Amortized      | Gross      | Gross      |             |
|                                     | Cost           | Unrealized | Unrealized |             |
|                                     |                | Gains      | Losses     | Fair Value  |
|                                     | (In thousands) |            |            |             |
| Debt Securities Available-for-Sale  |                |            |            |             |
| U.S. treasury securities            | \$348,677      | \$ 8       | \$ 141     | \$348,544   |
| U.S. government agency entities     | 8,397          | -          | 208        | 8,189       |
| U.S. government sponsored entities  | 400,000        | -          | 16,041     | 383,959     |
| Mortgage-backed securities          | 676,855        | 189        | 18,756     | 658,288     |
| Collateralized mortgage obligations | 1,233          | -          | 30         | 1,203       |
| Corporate debt securities           | 74,980         | 786        | -          | 75,766      |
| Total                               | \$1,510,142    | \$ 983     | \$ 35,176  | \$1,475,949 |

|  | December 31, 2017 |            |            |             |
|--|-------------------|------------|------------|-------------|
|  | Amortized         | Gross      | Gross      |             |
|  | Cost              | Unrealized | Unrealized | Fair Value  |
|  | (In thousands)    |            |            |             |
| <b>Securities Available-for-Sale</b>             |                   |            |            |             |
| U.S. treasury securities                         | \$249,877         | \$ -       | \$ 357     | \$249,520   |
| U.S. government agency entities                  | 9,047             | 11         | 70         | 8,988       |
| U.S. government sponsored entities               | 400,000           | -          | 9,664      | 390,336     |
| State and municipal securities                   | 1,944             | -          | 30         | 1,914       |
| Mortgage-backed securities                       | 577,987           | 241        | 6,259      | 571,969     |
| Collateralized mortgage obligations              | 1,533             | -          | 17         | 1,516       |
| Corporate debt securities                        | 80,007            | 1,291      | 17         | 81,281      |
| Mutual funds                                     | 6,500             | -          | 270        | 6,230       |
| Preferred stock of government sponsored entities | 5,842             | 4,260      | -          | 10,102      |
| Other equity securities                          | 3,608             | 8,162      | -          | 11,770      |
| Total  | \$1,336,345       | \$ 13,965  | \$ 16,684  | \$1,333,626 |

For additional information, see Note 7 to the Company's unaudited condensed consolidated financial statements.

Investment securities having a carrying value of \$158.1 million as of June 30, 2018, and \$272.2 million as of December 31, 2017, were pledged to secure public deposits, other borrowings, treasury tax and loan and securities sold under agreements to repurchase.

### **Equity Securities**

The adoption of ASU 2016-01 resulted in approximately \$8.6 million being reclassified from accumulated other comprehensive income to retained earnings, representing an increase to retained earnings as of January 1, 2018. For the six months ended June 30, 2018, the Company recognized a net loss of \$5.0 million due to the decrease in fair value of equity investments with readily determinable fair values. Equity securities were \$23.1 million as of June 30, 2018, compared to \$28.1 million as of December 31, 2017.

Table of Contents**Loans**

Gross loans, excluding loans held for sale, were \$13.3 billion at June 30, 2018, an increase of \$478 million, or 3.7%, from \$12.9 billion at December 31, 2017. The increase was primarily due to increases of \$316.8 million, or 10.3%, in residential mortgage loans, \$133.1 million, or 2.1%, in commercial mortgage loans, and \$115.4 million, or 4.7%, in commercial loans, which were partially offset by a decrease of \$96.9 million, or 14.3%, in real estate construction loans. The loan balances and composition at June 30, 2018, compared to December 31, 2017 are presented below:

|                                | <b>June 30,<br/>2018</b>      | <b>% of<br/>Gross<br/>Loans</b> | <b>December<br/>31, 2017</b> | <b>% of<br/>Gross<br/>Loans</b> | <b>%<br/>Change</b> |  |
|--------------------------------|-------------------------------|---------------------------------|------------------------------|---------------------------------|---------------------|--|
| <b>Type of Loans</b>           | <b>(Dollars in thousands)</b> |                                 |                              |                                 |                     |  |
| Commercial loans               | \$2,576,649                   | 19.3 %                          | \$2,461,266                  | 19.1 %                          | 4.7 %               |  |
| Residential mortgage loans     | 3,378,875                     | 25.3                            | 3,062,050                    | 23.8                            | 10.3                |  |
| Commercial mortgage loans      | 6,615,791                     | 49.6                            | 6,482,695                    | 50.4                            | 2.1                 |  |
| Equity lines                   | 191,445                       | 1.4                             | 180,304                      | 1.4                             | 6.2                 |  |
| Real estate construction loans | 581,917                       | 4.4                             | 678,805                      | 5.3                             | (14.3 )             |  |
| Installment and other loans    | 4,060                         | 0.0                             | 5,170                        | 0.0                             | (21.5 )             |  |
| Gross loans                    | \$13,348,737                  | 100 %                           | \$12,870,290                 | 100 %                           | 3.7 %               |  |
| Allowance for loan losses      | (121,899 )                    |                                 | (123,279 )                   |                                 | (1.1 )              |  |
| Unamortized deferred loan fees | (3,248 )                      |                                 | (3,245 )                     |                                 | 0.1                 |  |
| Total loans, net               | \$13,223,590                  |                                 | \$12,743,766                 |                                 | 3.8 %               |  |
| Loans held for sale            | \$-                           |                                 | \$8,000                      |                                 | (100.0 %)           |  |

**Non-performing Assets**

Non-performing assets include loans past due 90 days or more and still accruing interest, non-accrual loans, and other real estate owned ("OREO"). The Company's policy is to place loans on non-accrual status if interest and/or principal is past due 90 days or more, or in cases where management deems the full collection of principal and interest unlikely. After a loan is placed on non-accrual status, any previously accrued but unpaid interest is reversed and charged against current income and subsequent payments received are generally first applied towards the outstanding principal balance of the loan. Depending on the circumstances, management may elect to continue the accrual of interest on certain past due loans if partial payment is received and/or the loan is well collateralized and in the process of collection. The loan is generally returned to accrual status when the borrower has brought the past due principal and interest payments current and, in the opinion of management, the borrower has demonstrated the ability to make future payments of principal and interest as scheduled.

Management reviews the loan portfolio regularly for problem loans. During the ordinary course of business, management becomes aware of borrowers that may not be able to meet the contractual requirements of the loan agreements. Such loans are placed under closer supervision with consideration given to placing the loans on non-accrual status, the need for an additional allowance for loan losses, and (if appropriate) partial or full charge-off.

The ratio of non-performing assets, excluding non-accrual loans held for sale, to total assets was 0.4% at June 30, 2018, compared to 0.4% at December 31, 2017. Total non-performing assets increased \$2.7 million, or 4.6%, to \$60.9 million at June 30, 2018, compared to \$58.2 million at December 31, 2017, primarily due to an increase of \$3.9 million, or 8.0%, in non-accrual loans and offset by a decrease of \$1.2 million, or 12.9%, in other real estate owned.

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As a percentage of gross loans, excluding loans held for sale, plus OREO, our non-performing assets was 0.46% as of June 30, 2018, compared to 0.45% as of December 31, 2017. The non-performing loan portfolio coverage ratio, defined as the allowance for credit losses to non-performing loans, decreased to 237.0% as of June 30, 2018, from 262.1% as of December 31, 2017.

The following table presents the changes in non-performing assets and troubled debt restructurings (“TDRs”) as of June 30, 2018, compared to December 31, 2017, and to June 30, 2017:

| <b>(Dollars in thousands)</b>   | <b>June 30,<br/>2018</b> | <b>December<br/>31, 2017</b> | <b>%<br/>Change</b> | <b>June 30,<br/>2017</b> | <b>%<br/>Change</b> |
|---|--------------------------|------------------------------|---------------------|--------------------------|---------------------|
| <b>Non-performing assets</b>  |                          |                              |                     |                          |                     |
| Accruing loans past due 90 days or more   | \$-                      | \$-                          | -                   | \$495                    | (100 )              |
| Non-accrual loans:  |                          |                              |                     |                          |                     |
| Construction loans  | 8,040                    | 8,185                        | (2 )                | 16,585                   | (52 )               |
| Commercial mortgage loans   | 17,154                   | 19,820                       | (13 )               | 27,448                   | (38 )               |
| Commercial loans  | 19,212                   | 14,296                       | 34                  | 13,064                   | 47                  |
| Residential mortgage loans  | 8,322                    | 6,486                        | 28                  | 6,947                    | 20                  |
| Total non-accrual loans   | \$52,728                 | \$48,787                     | 8                   | \$64,044                 | (18 )               |
| Total non-performing loans  | 52,728                   | 48,787                       | 8                   | 64,539                   | (18 )               |
| Other real estate owned   | 8,220                    | 9,442                        | (13 )               | 19,230                   | (57 )               |
| Total non-performing assets   | \$60,948                 | \$58,229                     | 5                   | \$83,769                 | (27 )               |
| Accruing troubled debt restructurings   | \$84,487                 | \$68,565                     | 23                  | \$79,819                 | 6                   |
| Non-accrual loans held for sale   | \$-                      | \$8,000                      | (100 )              | \$-                      | -                   |
| Allowance for loan losses   | \$121,899                | \$123,279                    | (1 )                | \$115,809                | 5                   |
| Total gross loans outstanding, at period-end <sup>(1)</sup>                     | \$13,348,737             | \$12,870,290                 | 4                   | \$11,571,232             | 15                  |
| Allowance for loan losses to non-performing loans, at period-end <sup>(2)</sup> | 231.18                   | % 252.69                     | %                   | 179.44                   | %                   |
| Allowance for loan losses to gross loans, at period-end <sup>(1)</sup>          | 0.91                     | % 0.96                       | %                   | 1.00                     | %                   |

(1) Excludes loans held for sale at period-end.

(2) Excludes non-accrual loans held for sale at period-end.

**Non-accrual Loans**

At June 30, 2018, total non-accrual loans were \$52.7 million, an increase of \$3.9 million, or 8.0%, from \$48.8 million at December 31, 2017, and a decrease of \$11.3 million, or 17.7%, from \$64.0 million at June 30, 2017. The allowance for the collateral-dependent loans is calculated based on the difference between the outstanding loan balance and the value of the collateral as determined by recent appraisals, sales contracts, or other available market price information, less cost to sell. The allowance for collateral-dependent loans varies from loan to loan based on the collateral coverage of the loan at the time of designation as non-performing. We continue to monitor the collateral coverage of these loans, based on recent appraisals, on a quarterly basis and adjust the allowance accordingly. Non-accrual loans also include those TDRs that do not qualify for accrual status.

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The following tables present the type of properties securing the non-accrual portfolio loans and the type of businesses the borrowers engaged in as of the dates indicated:

|                               | <b>June 30, 2018</b>  |                   | <b>December 31, 2017</b> |                   |
|-------------------------------|-----------------------|-------------------|--------------------------|-------------------|
|                               | <b>Real</b>           |                   | <b>Real</b>              |                   |
|                               | <b>Estate</b>         | <b>Commercial</b> | <b>Estate</b>            | <b>Commercial</b> |
|                               | <b>(1)</b>            |                   | <b>(1)</b>               |                   |
|                               | <b>(In thousands)</b> |                   |                          |                   |
| <b>Type of Collateral</b>     |                       |                   |                          |                   |
| Single/multi-family residence | \$ 15,096             | \$ 8,430          | \$ 14,952                | \$ 7,575          |
| Commercial real estate        | 16,941                | -                 | 19,540                   | -                 |
| Personal property (UCC)       | 1,479                 | 10,782            | -                        | 6,721             |
| Total                         | \$ 33,516             | \$ 19,212         | \$ 34,492                | \$ 14,296         |

(1) Real estate includes commercial mortgage loans, real estate construction loans, residential mortgage loans and equity lines.

|                         | <b>June 30, 2018</b>  |                   | <b>December 31, 2017</b> |                   |
|-------------------------|-----------------------|-------------------|--------------------------|-------------------|
|                         | <b>Real</b>           |                   | <b>Real</b>              |                   |
|                         | <b>Estate</b>         | <b>Commercial</b> | <b>Estate</b>            | <b>Commercial</b> |
|                         | <b>(1)</b>            |                   | <b>(1)</b>               |                   |
|                         | <b>(In thousands)</b> |                   |                          |                   |
| <b>Type of Business</b> |                       |                   |                          |                   |
| Real estate development | \$ 13,855             | \$ -              | \$ 16,672                | \$ -              |
| Wholesale/Retail        | 11,650                | 12,658            | 11,429                   | 7,743             |
| Food/Restaurant         | 124                   | -                 | 137                      | -                 |
| Import/Export           | -                     | 6,554             | -                        | 6,553             |
| Other                   | 7,887                 | -                 | 6,254                    | -                 |
| Total                   | \$ 33,516             | \$ 19,212         | \$ 34,492                | \$ 14,296         |

(1) Real estate includes commercial mortgage loans, real estate construction loans, residential mortgage loans and equity lines.

**Impaired Loans**



A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement based on current circumstances and events. The assessment for impairment occurs when and while such loans are on non-accrual as a result of delinquency status of over 90 days or receipt of information indicating that full collection of principal is doubtful, or when the loan has been restructured in a troubled debt restructuring (TDRs). Those loans with a balance less than our defined selection criteria, generally a loan amount less than \$500,000, are treated as a homogeneous portfolio. If loans meeting the defined criteria are not collateral dependent, we measure the impairment based on the present value of the expected future cash flows discounted at the loan's effective interest rate. If loans meeting the defined criteria are collateral dependent, we measure the impairment by using the loan's observable market price or the fair value of the collateral. We obtain an appraisal to determine the amount of impairment at the date that the loan becomes impaired. The appraisals are based on "as is" or bulk sale valuations. To ensure that appraised values remain current, we generally obtain an updated appraisal every twelve months from qualified independent appraisers. If the fair value of the collateral, less cost to sell, is less than the recorded amount of the loan, we then recognize impairment by creating or adjusting an existing valuation allowance with a corresponding charge to the provision for loan losses. If an impaired loan is expected to be collected through liquidation of the collateral, the amount of impairment, excluding disposal costs, which range between 3% to 6% of the fair value, depending on the size of the impaired loan, is charged off against the allowance for loan losses. Non-accrual impaired loans, including TDRs, are not returned to accrual status unless the unpaid interest has been brought current and full repayment of the recorded balance is expected or if the borrower has made six consecutive monthly payments of the scheduled amounts due, and TDRs are reviewed for continued impairment until they are no longer reported as TDRs.

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As of June 30, 2018, recorded investment in impaired loans totaled \$137.2 million and was comprised of non-accrual loans, excluding loans held for sale, of \$52.7 million and accruing troubled debt restructured loans (TDRs) of \$84.5 million. As of December 31, 2017, recorded investment in impaired loans totaled \$117.4 million and was comprised of non-accrual loans, excluding loans held for sale, of \$48.8 million and accruing TDRs of \$68.6 million. For impaired loans, the amounts previously charged off represent 6.5% as of June 30, 2018, and 7.2% as of December 31, 2017, of the contractual balances for impaired loans. As of June 30, 2018, \$33.5 million, or 63.6%, of the \$52.7 million of non-accrual loans, excluding loans held for sale, was secured by real estate compared to \$34.5 million, or 70.7%, of the \$48.8 million of non-accrual loans, excluding loans held for sale, that was secured by real estate as of December 31, 2017. The Bank obtains current appraisals, sales contracts, or other available market price information intended to provide updated factors in evaluating potential loss.

As of June 30, 2018, \$3.8 million of the \$121.9 million allowance for loan losses was allocated for impaired loans and \$118.1 million was allocated to the general allowance. As of December 31, 2017, \$2.1 million of the \$123.3 million allowance for loan losses was allocated for impaired loans and \$121.1 million was allocated to the general allowance.

The allowance for loan losses to non-accrual loans was 231.2% as of June 30, 2018, from 252.7% as of December 31, 2017, primarily due to an increase in the non-accrual loans. Non-accrual loans also include those TDRs that do not qualify for accrual status.

The following table presents impaired loans and the related allowance as of the dates indicated:

|   | <b>Impaired Loans<br/>June 30, 2018</b> |                                |                  | <b>December 31, 2017</b> |                                |                  |
|---|---|--------------------------------|------------------|--------------------------|--------------------------------|------------------|
|   | <b>Unpaid</b>                           |                                |                  | <b>Unpaid</b>            |                                |                  |
|   | <b>Principal</b>                        | <b>Recorded<br/>Investment</b> | <b>Allowance</b> | <b>Principal</b>         | <b>Recorded<br/>Investment</b> | <b>Allowance</b> |
|   | <b>Balance</b>                          |                                |                  | <b>Balance</b>           |                                |                  |
|   | <b>(In thousands)</b>                   |                                |                  |                          |                                |                  |
| <b>With no allocated allowance</b>          |   |                                |                  |                          |                                |                  |
| Commercial loans                            | \$51,143                                | \$ 49,521                      | \$ -             | \$43,483                 | \$ 42,702                      | \$ -             |
| Real estate construction loans              | 8,821                                   | 8,040                          | -                | 8,821                    | 8,185                          | -                |
| Commercial mortgage loans                   | 41,970                                  | 34,508                         | -                | 37,825                   | 31,029                         | -                |
| Residential mortgage loans and equity lines | 6,551                                   | 6,543                          | -                | 1,301                    | 1,301                          | -                |
| Subtotal                                    | \$108,485                               | \$ 98,612                      | \$ -             | \$91,430                 | \$ 83,217                      | \$ -             |
| <b>With allocated allowance</b>             |   |                                |                  |                          |                                |                  |
| Commercial loans                            | \$3,247                                 | \$ 3,218                       | \$ 2,463         | \$891                    | \$ 793                         | \$ 43            |
| Commercial mortgage loans                   | 27,495                                  | 27,445                         | 1,036            | 21,733                   | 21,635                         | 1,738            |

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|   |                  |                   |                 |                  |                   |                 |
|---|------------------|-------------------|-----------------|------------------|-------------------|-----------------|
| Residential mortgage loans and equity lines | 9,143            | 7,939             | 334             | 13,022           | 11,708            | 353             |
| Subtotal                                    | \$39,885         | \$ 38,602         | \$ 3,833        | \$35,646         | \$ 34,136         | \$ 2,134        |
| <b>Total impaired loans</b>                 | <b>\$148,370</b> | <b>\$ 137,214</b> | <b>\$ 3,833</b> | <b>\$127,076</b> | <b>\$ 117,353</b> | <b>\$ 2,134</b> |

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**Loan Interest Reserves**

In accordance with customary banking practice, construction loans and land development loans are originated where interest on the loan is disbursed from pre-established interest reserves included in the total original loan commitment. Our construction and land development loans generally include optional renewal terms after the maturity of the initial loan term. New appraisals are obtained prior to extension or renewal of these loans in part to determine the appropriate interest reserve to be established for the new loan term. Loans with interest reserves are underwritten to the same criteria, including loan to value and, if applicable, pro forma debt service coverage ratios, as loans without interest reserves. Construction loans with interest reserves are monitored on a periodic basis to gauge progress towards completion. Interest reserves are frozen if it is determined that additional draws would result in a loan to value ratio that exceeds policy maximums based on collateral property type. Our policy limits in this regard are consistent with supervisory limits and range from 65% in the case of land to 85% in the case of one to four family residential construction projects.

As of June 30, 2018, construction loans of \$522.9 million were disbursed with pre-established interest reserves of \$77.8 million compared to \$545.0 million of such loans disbursed with pre-established interest reserves of \$72.3 million at December 31, 2017. The balance for construction loans with interest reserves that have been extended was \$92.3 million with pre-established interest reserves of \$3.3 million at June 30, 2018, compared to \$62.1 million with pre-established interest reserves of \$2.0 million at December 31, 2017. Land loans of \$11.6 million were disbursed with pre-established interest reserves of \$304,000 at June 30, 2018, compared to \$32.7 million of land loans disbursed with pre-established interest reserves of \$1.3 million at December 31, 2017. The balance for land loans with interest reserves that have been extended was \$5.5 million at June 30, 2018 with pre-established interest reserves of \$124,000 compared to \$6.9 million in land loans with pre-established interest reserves of \$221,000 at December 31, 2017.

At June 30, 2018 and December 31, 2017, the Bank had no loans on non-accrual status with available interest reserves. At June 30, 2018, \$8.0 million of non-accrual non-residential construction loans had been originated with pre-established interest reserves. At December 31, 2017, \$8.2 million of non-accrual non-residential construction loans and \$8.0 million of non-accrual land loans had been originated with pre-established interest reserves. While we typically expect loans with interest reserves to be repaid in full according to the original contractual terms, some loans require one or more extensions beyond the original maturity before full repayment. Typically, these extensions are required due to construction delays, delays in the sale or lease of property, or some combination of these two factors.

**Loan Concentration**

Most of the Company's business activities are with customers located in the high-density Asian-populated areas of Southern and Northern California; New York City, New York; Dallas and Houston, Texas; Seattle, Washington; Boston, Massachusetts; Chicago, Illinois; Edison, New Jersey; Rockville, Maryland; Las Vegas, Nevada; and Hong

Kong. The Company has no specific industry concentration, and generally its loans are collateralized with real property or other pledged collateral of the borrowers. The Company generally expects loans to be paid off from the operating profits of the borrowers, refinancing by another lender, or through sale by the borrowers of the collateral. There were no loan concentrations to multiple borrowers in similar activities that exceeded 10% of total loans as of June 30, 2018, or as of December 31, 2017.

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The federal banking regulatory agencies issued final guidance on December 6, 2006, regarding risk management practices for financial institutions with high or increasing concentrations of commercial real estate (“CRE”) loans on their balance sheets. The regulatory guidance reiterates the need for sound internal risk management practices for those institutions that have experienced rapid growth in CRE lending, have notable exposure to specific types of CRE, or are approaching or exceeding the supervisory criteria used to evaluate the CRE concentration risk, but the guidance is not to be construed as a limit for CRE exposure. The supervisory criteria are: (1) total reported loans for construction, land development, and other land represent 100% of the institution’s total risk-based capital, and (2) total CRE loans represent 300% or more of the institution’s total risk-based capital and the institution’s CRE loan portfolio has increased 50% or more within the last thirty-six months. Total loans for construction, land development, and other land represented 33% of the Bank’s total risk-based capital as of June 30, 2018, and 41% as of December 31, 2017. Total CRE loans represented 281% of total risk-based capital as of June 30, 2018, and 293% as of December 31, 2017 and were below the Bank’s internal limit for CRE loans of 400% of total capital at both dates.

**Allowance for Credit Losses**

The Bank maintains the allowance for credit losses at a level that the Bank considers appropriate to absorb the estimated and known risks in the loan portfolio and off-balance sheet unfunded credit commitments. Allowance for credit losses is comprised of the allowance for loan losses and the reserve for off-balance sheet unfunded credit commitments. With this risk management objective, the Bank’s management has an established monitoring system that is designed to identify impaired and potential problem loans, and to permit periodic evaluation of impairment and the appropriate level of the allowance for credit losses in a timely manner.

In addition, the Bank’s Board of Directors has established a written credit policy that includes a credit review and control system that the Board of Directors believes should be effective in ensuring that the Bank maintains an appropriate allowance for credit losses. The Board of Directors provides oversight for the allowance evaluation process, including quarterly evaluations, and determines whether the allowance is appropriate to absorb losses in the credit portfolio. The determination of the amount of the allowance for credit losses and the provision for credit losses are based on management’s current judgment about the credit quality of the loan portfolio and take into consideration known relevant internal and external factors that affect collectability when determining the appropriate level for the allowance for credit losses. The nature of the process by which the Bank determines the appropriate allowance for credit losses requires the exercise of considerable judgment. Additions to the allowance for credit losses are made by charges to the provision for credit losses. While management utilizes its best judgment based on the information available, the ultimate appropriateness of the allowance is dependent upon a variety of factors beyond the Bank’s control, including the performance of the Bank’s loan portfolio, the economy, changes in interest rates, and the view of the regulatory authorities toward loan classifications. Identified credit exposures that are determined to be uncollectible are charged against the allowance for credit losses. Recoveries of previously charged off amounts, if any, are credited to the allowance for credit losses. A weakening of the economy or other factors that adversely affect asset quality could result in an increase in the number of delinquencies, bankruptcies, or defaults, and a higher level of non-performing assets, net charge-offs, and provision for credit losses in future periods.

The allowance for loan losses was \$121.9 million and the allowance for off-balance sheet unfunded credit commitments was \$3.1 million at June 30, 2018, which represented the amount believed by management to be appropriate to absorb credit losses inherent in the loan portfolio, including unfunded credit commitments. The \$121.9 million allowance for loan losses at June 30, 2018, decreased \$1.4 million, or 1.1%, from \$123.3 million at December 31, 2017. The allowance for loan losses represented 0.91% of period-end gross loans, excluding loans held for sale, and 231.2% of non-performing loans at June 30, 2018. The comparable ratios were 0.96% of period-end gross loans, excluding loans held for sale, and 252.7% of non-performing loans at December 31, 2017.

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The following table sets forth information relating to the allowance for loan losses, charge-offs, recoveries, and the reserve for off-balance sheet credit commitments for the periods indicated:

|   | Three months ended June 30, 2018 |    |              |    | Six months ended June 30, 2017 |    |              |    |
|---|----------------------------------|----|--------------|----|--------------------------------|----|--------------|----|
|   | 2018                             |    | 2017         |    | 2018                           |    | 2017         |    |
|   | (Dollars in thousands)           |    |              |    |                                |    |              |    |
| <b>Allowance for loan losses</b>  |                                  |    |              |    |                                |    |              |    |
| Balance at beginning of period  | \$122,084                        |    | \$115,544    |    | \$123,279                      |    | \$118,966    |    |
| Reversal for credit losses  | -                                |    | -            |    | (3,000 )                       |    | (2,500 )     |    |
| Charge-offs :   |                                  |    |              |    |                                |    |              |    |
| Commercial loans  | (488 )                           |    | (527 )       |    | (507 )                         |    | (1,730 )     |    |
| Real estate loans   | (390 )                           |    | -            |    | (390 )                         |    | (555 )       |    |
| Total charge-offs   | (878 )                           |    | (527 )       |    | (897 )                         |    | (2,285 )     |    |
| Recoveries:   |                                  |    |              |    |                                |    |              |    |
| Commercial loans  | 150                              |    | 335          |    | 1,063                          |    | 826          |    |
| Construction loans  | 44                               |    | 47           |    | 88                             |    | 96           |    |
| Real estate loans   | 499                              |    | 410          |    | 1,366                          |    | 706          |    |
| Total recoveries  | 693                              |    | 792          |    | 2,517                          |    | 1,628        |    |
| Balance at end of period  | \$121,899                        |    | \$115,809    |    | \$121,899                      |    | \$115,809    |    |
| <b>Reserve for off-balance sheet credit commitments</b>   |                                  |    |              |    |                                |    |              |    |
| Balance at beginning of period  | \$4,588                          |    | \$3,424      |    | \$4,588                        |    | \$3,224      |    |
| Provision for credit losses   | (1,500 )                         |    | 1,089        |    | (1,500 )                       |    | 1,289        |    |
| Balance at end of period  | \$3,088                          |    | \$4,513      |    | \$3,088                        |    | \$4,513      |    |
| Average loans outstanding during the period <sup>(1)</sup>  | \$13,020,212                     |    | \$11,388,057 |    | \$12,970,484                   |    | \$11,338,983 |    |
| Total gross loans outstanding, at period-end <sup>(1)</sup>   | \$13,348,737                     |    | \$11,571,232 |    | \$13,348,737                   |    | \$11,571,232 |    |
| Total non-performing loans, at period-end <sup>(2)</sup>  | \$52,728                         |    | \$64,539     |    | \$52,728                       |    | \$64,539     |    |
| Ratio of net (recoveries)/charge-offs to average loans outstanding during the period <sup>(1)</sup> | 0.01                             | %  | (0.01        | %) | (0.03                          | %) | 0.01         | %  |
| Provision for credit losses to average loans outstanding during the period <sup>(1)</sup>           | (0.05                            | %) | 0.04         | %  | (0.07                          | %) | (0.02        | %) |
| Allowance for credit losses to non-performing loans, at period-end <sup>(2)</sup>                   | 237.04                           | %  | 186.43       | %  | 237.04                         | %  | 186.43       | %  |
| Allowance for credit losses to gross loans, at period-end <sup>(1)</sup>                            | 0.94                             | %  | 1.04         | %  | 0.94                           | %  | 1.04         | %  |

(1) Excluding loans held for sale.

(2) Excluding non-accrual loans held for sale.



Our allowance for loan losses consists of the following:

Specific allowance: For impaired loans, we provide specific allowances for loans that are not collateral dependent based on an evaluation of the present value of the expected future cash flows discounted at the loan's effective interest rate and for loans that are collateral dependent based on the fair value of the underlying collateral determined by the most recent valuation information received, which may be adjusted based on factors such as changes in market conditions from the time of valuation. If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the allowance for loan losses or, alternatively, a specific allocation will be established.

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General allowance: The unclassified portfolio is segmented on a group basis. Segmentation is determined by loan type and common risk characteristics. The non-impaired loans are grouped into 19 segments: two commercial segments, ten commercial real estate segments, one residential construction segment, one non-residential construction segment, one SBA segment, one installment loans segment, one residential mortgage segment, one equity lines of credit segment, and one overdrafts segment. The allowance is provided for each segmented group based on the group's historical loan loss experience aggregated based on loan risk classifications which take into account the current financial condition of the borrowers and guarantors, the prevailing value of the underlying collateral if collateral dependent, charge-off history, management's knowledge of the portfolio, general economic conditions, environmental factors including the trends in delinquency and non-accrual, and other significant factors, such as the national and local economy, volume and composition of the portfolio, strength of management and loan staff, underwriting standards, and concentration of credit. In addition, management review reports on past-due loans to ensure appropriate classification.

The table set forth below reflects management's allocation of the allowance for loan losses by loan category and the ratio of each loan category to the average gross loans as of the dates indicated:

|   | June 30, 2018 |   |                        | December 31, 2017 |   |   |
|---|---------------|---|------------------------|-------------------|---|---|
|   | Amount        | Percentage<br>of<br>Loans in<br>Each<br>Category<br>to<br>Average<br>Gross<br>Loans | (Dollars in thousands) | Amount            | Percentage<br>of<br>Loans in<br>Each<br>Category<br>to<br>Average<br>Gross<br>Loans |   |
| Type of Loan:                             |               |   |                        |                   |   |   |
| Commercial loans                          | \$55,179      | 18.6  | %                      | \$49,796          | 19.1  | % |
| Residential mortgage loans <sup>(1)</sup> | 12,062        | 26.0  |                        | 11,013            | 24.5  |   |
| Commercial mortgage loans                 | 33,976        | 50.6  |                        | 37,610            | 51.2  |   |
| Real estate construction loans            | 20,663        | 4.8   |                        | 24,838            | 5.2   |   |
| Installment and other loans               | 19            | 0.0   |                        | 22                | 0.0   |   |
| Total                                     | \$121,899     | 100   | %                      | \$123,279         | 100   | % |

(1) Residential mortgage loans includes equity lines.

The allowance allocated to commercial loans increased \$5.4 million, or 10.8%, to \$55.2 million at June 30, 2018, from \$49.8 million at December 31, 2017. The increase is a result of the continued trade instability and pending tariffs

between the U.S. and China and an increase in non-accrual and past due commercial loans in the first and second quarter of 2018.

The allowance allocated for residential mortgage loans increased by \$1.1 million, or 9.5%, to \$12.1 million as of June 30, 2018, from \$11.0 million at December 31, 2017 primarily due to the increase in volume.

The allowance allocated to commercial mortgage loans decreased \$3.6 million, or 9.7%, to \$34.0 million at June 30, 2018, from \$37.6 million at December 31, 2017 as a result of the \$59.9 million decrease in substandard loans and net recoveries in the first half of 2018.

The allowance allocated to real estate construction loans decreased \$4.1 million, or 16.8%, to \$20.7 million at June 30, 2018 from \$24.8 million at December 31, 2017. The decrease is due primarily to the decrease in loans outstanding during the first half of 2018.

Table of Contents**Deposits**

Total deposits were \$13.1 billion at June 30, 2018, an increase of \$415 million, or 3.3%, from \$12.7 billion at December 31, 2017. The following table displays the deposit mix as of the dates indicated:

|                                      | June 30, 2018                 |            |   | December 31, 2017 |            |   |
|--------------------------------------|-------------------------------|------------|---|-------------------|------------|---|
|                                      | Amount                        | Percentage |   | Amount            | Percentage |   |
|                                      | <b>(Dollars in thousands)</b> |            |   |                   |            |   |
| <b>Deposits</b>                      |                               |            |   |                   |            |   |
| Non-interest-bearing demand deposits | \$2,835,314                   | 21.6       | % | \$2,783,127       | 21.9       | % |
| Interest bearing demand deposits     | 1,381,617                     | 10.6       |   | 1,410,519         | 11.1       |   |
| Money market deposits                | 2,263,991                     | 17.3       |   | 2,248,271         | 17.7       |   |
| Savings deposits                     | 790,125                       | 6.0        |   | 857,199           | 6.8        |   |
| Time deposits                        | 5,833,499                     | 44.5       |   | 5,390,777         | 42.5       |   |
| Total deposits                       | \$13,104,546                  | 100.0      | % | \$12,689,893      | 100.0      | % |

The following table shows the maturity distribution of time deposits as of June 30, 2018:

|                           | <b>At June 30, 2018</b>   |  |                                    |   |
|---------------------------|---|--|------------------------------------|---|
|                           | <b>Time<br/>Deposits -<br/>under<br/>\$100,000<br/>(In thousands)</b> | <b>Time<br/>Deposits<br/>-\$100,000<br/>and over</b> | <b>Total<br/>Time<br/>Deposits</b> |   |
| Less than three months    | \$224,920   | \$1,361,845  | \$1,586,765                        |   |
| Three to six months       | 172,024   | 788,904  | 960,928                            |   |
| Six to twelve months      | 800,205   | 1,522,724  | 2,322,929                          |   |
| Over one year             | 327,145   | 635,732  | 962,877                            |   |
| Total                     | \$1,524,294   | \$4,309,205  | \$5,833,499                        |   |
| Percent of total deposits | 11.6  | %  | 32.9                               | % |
|                           |   |  | 44.5                               | % |

**Borrowings**

Borrowings include federal funds purchased, securities sold under agreements to repurchase, funds obtained as advances from the FHLB of San Francisco, and borrowings from other financial institutions.

*Securities Sold Under Agreements to Repurchase.* Securities sold under agreements to repurchase were \$50 million with a weighted average rate of 2.98% at June 30, 2018, compared to \$100 million with a weighted average rate of 2.86% at December 31, 2017. Final maturity for the fixed rate non-callable securities sold under agreements to repurchase was \$50.0 million in July 2018.

These transactions are accounted for as collateralized financing transactions and recorded at the amounts at which the securities were sold. The Company may have to provide additional collateral for the repurchase agreements, as necessary. The underlying collateral pledged for the repurchase agreements consists of U.S. Treasury securities and mortgage-backed securities with a fair value of \$55.4 million as of June 30, 2018, and \$108.4 million as of December 31, 2017.

*Borrowing from the FHLB.* As of June 30, 2018, over-night borrowings from the FHLB were \$160 million at a rate of 2.08% compared to \$325 million at a rate of 1.41% as of December 31, 2017. As of June 30, 2018, the advances from the FHLB were \$320 million at a rate of 1.78% compared to \$105 million at a rate of 1.41% as of December 31, 2017. As of June 30, 2018, FHLB advances of \$245 million will mature in July 2018, \$5 million in October 2018, \$50 million in December 2019, and \$20 million in May 2023.

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*Other Borrowing.* Pursuant to the Stock Purchase Agreement with Bank SinoPac Co. Ltd, \$35.2 million of the purchase price was held back at a floating rate of three-month LIBOR rate plus 150 basis points and 50%, 30%, and 20% will be disbursed annually over three years on the anniversary dates, respectively. As of June 30, 2018, the outstanding balance was \$36.0 million with a rate of 2.8% compared to \$35.2 million at December 31, 2017.

*Long-term Debt.* On October 12, 2017, the Bank entered into a term loan agreement of \$75.0 million with U.S. Bank. The loan has a floating rate of one-month LIBOR plus 175 basis points. As of June 30, 2018, the term loan has an interest rate of 3.750% compared to 3.125% at December 31, 2017. The principal amount of the long-term debt from U.S. Bank is due and payable in consecutive quarterly installments of \$4.7 million each on the last day of each calendar quarter commencing December 31, 2018, with the final installment due and payable on October 12, 2020. We used the U.S. Bank loan proceeds to fund a portion of our acquisition of SinoPac Bancorp.

At June 30, 2018, Junior Subordinated Notes totaled \$119.1 million with a weighted average interest rate of 4.51%, compared to \$119.1 million with a weighted average rate of 3.78% at December 31, 2017. The Junior Subordinated Notes have a stated maturity term of 30 years. As of June 30, 2018, and December 31, 2017, the Company's assets exceeded the \$15 billion threshold and, as a result, the Junior Subordinated Notes no longer qualify as Tier 1 capital for regulatory reporting purposes. The trusts are not consolidated with the Company in accordance with an accounting pronouncement that took effect in December 2003.

Table of Contents**Off-Balance-Sheet Arrangements and Contractual Obligations**

The following table summarizes the Company's contractual obligations to make future payments as of June 30, 2018. Payments for deposits and borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts.

|   | <b>Payment Due by Period</b> |   |  |                            | <b>Total</b> |
|---|------------------------------|---|--|----------------------------|--------------|
|   | <b>1 year<br/>or less</b>    | <b>More than<br/>1 year but<br/>less than<br/>3 years</b> | <b>3 years<br/>or<br/>more<br/>but<br/>less<br/>than<br/>5 years</b> | <b>5 years<br/>or more</b> |              |
|   | <b>(In thousands)</b>        |   |  |                            |              |
| Contractual obligations:                                    |                              |   |  |                            |              |
| Deposits with stated maturity dates                         | \$4,870,623                  | \$924,908   | \$37,954   | \$14                       | \$5,833,499  |
| Non-callable securities sold under agreements to repurchase | 50,000                       | -   | -  | -                          | 50,000       |
| Advances from the Federal Home Loan Bank                    | 410,000                      | 50,000  | 20,000   | -                          | 480,000      |
| Other borrowings  | 18,007                       | 18,008  | -  | 17,382                     | 53,397       |
| Long-term debt  | 4,688                        | 70,312  | -  | 119,136                    | 194,136      |
| Operating leases  | 10,094                       | 13,617  | 9,394  | 6,792                      | 39,897       |
| Total contractual obligations and other commitments         | \$5,363,412                  | \$1,076,845   | \$67,348   | \$143,324                  | \$6,650,929  |

In the normal course of business, we enter into various transactions, which, in accordance with U.S. generally accepted accounting principles, are not included in our condensed consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the condensed consolidated balance sheets.

*Loan Commitments.* We enter into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of

the allowance for credit losses.

*Standby Letters of Credit.* Standby letters of credit are written conditional commitments issued by us to secure the obligations of a customer to a third party. In the event the customer does not perform in accordance with the terms of an agreement with the third party, we would be required to fund the commitment. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, we would be entitled to seek reimbursement from the customer. Our policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.



Table of ContentsCapital Resources

Total equity was \$2.1 billion as of June 30, 2018, an increase of \$91.5 million, from \$1.97 billion as of December 31, 2017, primarily due to net income of \$137.5 million offset by common stock cash dividends of \$39.0 million and decreases of other comprehensive income of \$20.4 million due in part to the adoption of new accounting pronouncements in the first quarter of 2018.

The following table summarizes changes in total equity for the six months ended June 30, 2018:

| (In thousands)   | Six<br>months<br>ended<br>June 30,<br>2018 |
|--|--|
| Net income   | \$ 137,480                                 |
| Stock issued to directors  | 650  |
| Stock options exercised and RSUs distributed   | 838  |
| Proceeds from shares issued through the Dividend Reinvestment Plan                       | 1,325                                      |
| Shares withheld related to net share settlement of RSUs                                  | (1,865 )                                   |
| Share-based compensation   | 3,404                                      |
| Other comprehensive income   | (20,408 )                                  |
| Retained earnings adjustments upon initial adoption of new pronouncements <sup>(1)</sup> | 9,073                                      |
| Cash dividends paid to common stockholders   | (38,966 )                                  |
| Net increase in total equity   | \$91,531                                   |

<sup>(1)</sup> These adjustments are a result of the adoption of ASU 2016-01 and 2018-2, effective as of January 1, 2018.

**Capital Adequacy Review**

Management seeks to maintain the Company's capital at a level sufficient to support future growth, protect depositors and stockholders, and comply with various regulatory requirements.

Both Bancorp's and the Bank's regulatory capital continued to exceed the regulatory minimum requirements under Basel III rules that became effective January 1, 2015, with transitional provisions as of June 30, 2018. In addition, the capital ratios of the Bank place it in the "well capitalized" category, which is defined as institutions with a common equity tier 1 capital ratio equal to or greater than 6.5%, a Tier 1 risk-based capital ratio equal to or greater than 8%, a total risk-based capital ratio equal to or greater than 10%, and a Tier 1 leverage capital ratio equal to or greater than 5%.

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The following table presents Bancorp's and the Bank's capital and leverage ratios as of June 30, 2018, and December 31, 2017:

| (Dollars in thousands)                                 | Cathay General Bancorp |       |                   |       | Cathay Bank   |       |                   |       |
|--|------------------------|-------|-------------------|-------|---------------|-------|-------------------|-------|
|  | June 30, 2018          |       | December 31, 2017 |       | June 30, 2018 |       | December 31, 2017 |       |
|  | Balance                | %     | Balance           | %     | Balance       | %     | Balance           | %     |
| Common equity Tier 1 capital (to risk-weighted assets) | \$1,683,777            | 12.59 | \$1,572,025       | 12.19 | \$1,817,923   | 13.61 | \$1,734,719       | 13.46 |
| Common equity Tier 1 capital minimum requirement       | 602,059                | 4.50  | 580,552           | 4.50  | 601,119       | 4.50  | 579,921           | 4.50  |
| Excess   | \$1,081,718            | 8.09  | \$991,473         | 7.69  | \$1,216,804   | 9.11  | \$1,154,798       | 8.96  |
| Tier 1 capital (to risk-weighted assets)               | \$1,683,777            | 12.59 | \$1,572,025       | 12.19 | \$1,817,923   | 13.61 | \$1,734,719       | 13.46 |
| Tier 1 capital minimum requirement                     | 802,745                | 6.00  | 774,070           | 6.00  | 801,492       | 6.00  | 773,229           | 6.00  |
| Excess   | \$881,032              | 6.59  | \$797,955         | 6.19  | \$1,016,431   | 7.61  | \$961,490         | 7.46  |
| Total capital (to risk-weighted assets)                | \$1,924,264            | 14.38 | \$1,820,860       | 14.11 | \$1,942,910   | 14.54 | \$1,862,806       | 14.45 |
| Total capital minimum requirement                      | 1,070,327              | 8.00  | 1,032,093         | 8.00  | 1,068,656     | 8.00  | 1,030,971         | 8.00  |
| Excess   | \$853,937              | 6.38  | \$788,767         | 6.11  | \$874,254     | 6.54  | \$831,835         | 6.45  |
| Tier 1 capital (to average assets) – Leverage ratio    | \$1,683,777            | 10.96 | \$1,572,025       | 10.35 | \$1,817,923   | 11.85 | \$1,734,719       | 11.82 |
| Minimum leverage requirement                           | 614,706                | 4.00  | 607,349           | 4.00  | 613,831       | 4.00  | 586,959           | 4.00  |
| Excess   | \$1,069,071            | 6.96  | \$964,676         | 6.35  | \$1,204,092   | 7.85  | \$1,147,760       | 7.82  |
| Risk-weighted assets                                   | \$13,379,087           |       | \$12,901,161      |       | \$13,358,204  |       | \$12,887,142      |       |
| Total average assets <sup>(1)</sup>                    | \$15,367,647           |       | \$15,183,720      |       | \$15,345,772  |       | \$14,673,981      |       |

The quarterly total average assets reflect all debt securities at amortized cost, equity securities with readily determinable fair values at the lower of cost or fair value, and equity securities without readily determinable fair values at historical cost.

Dividend Policy

Holders of common stock are entitled to dividends as and when declared by our Board of Directors out of funds legally available for the payment of dividends. Although we have historically paid cash dividends on our common stock, we are not required to do so. The amount of future dividends will depend on our earnings, financial condition, capital requirements and other factors, and will be determined by our Board of Directors. The terms of our Junior Subordinated Notes also limit our ability to pay dividends. We increased the common stock dividend from \$0.21 per share in the fourth quarter of 2016, to \$0.24 per share in the fourth quarter of 2017.

The Company declared a cash dividend of \$0.24 per share on 81,240,446 shares outstanding on June 1, 2018, for distribution to holders of our common stock on June 11, 2018, and \$0.24 per share on 81,126,888 shares outstanding on March 1, 2018, for distribution to holders of our common stock on March 12, 2018. The Company paid total cash dividends of \$39.0 million during the first six months of 2018.

### **Financial Derivatives**

It is the policy of the Company not to speculate on the future direction of interest rates. However, the Company enters into financial derivatives in order to seek mitigation of exposure to interest rate risks related to our interest-earning assets and interest-bearing liabilities. We believe that these transactions, when properly structured and managed, may provide a hedge against inherent interest rate risk in the Company's assets or liabilities and against risk in specific transactions. In such instances, the Company may enter into interest rate swap contracts or other types of financial derivatives. Prior to considering any hedging activities, we seek to analyze the costs and benefits of the hedge in comparison to other viable alternative strategies. All hedges must be approved by the Bank's Investment Committee.

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The Company follows ASC Topic 815 that establishes accounting and reporting standards for financial derivatives, including certain financial derivatives embedded in other contracts, and hedging activities. It requires the recognition of all financial derivatives as assets or liabilities in the Company's consolidated balance sheet and measurement of those financial derivatives at fair value. The accounting treatment of changes in fair value is dependent upon whether or not a financial derivative is designated as a hedge and, if so, the type of hedge. Fair value is determined using third-party models with observable market data. For derivatives designated as cash flow hedges, changes in fair value are recognized in other comprehensive income and are reclassified to earnings when the hedged transaction is reflected in earnings. For derivatives designated as fair value hedges, changes in the fair value of the derivatives are reflected in current earnings, together with changes in the fair value of the related hedged item if there is a highly effective correlation between changes in the fair value of the interest rate swaps and changes in the fair value of the underlying asset or liability that is intended to be hedged. If there is not a highly effective correlation between changes in the fair value of the interest rate swap and changes in the fair value of the underlying asset or liability that is intended to be hedged, then only the changes in the fair value of the interest rate swaps are reflected in the Company's consolidated financial statements.

In May 2014, the Bancorp entered into interest rate swap contracts in the notional amount of \$119.1 million for a period of ten years. The objective of these interest rate swap contracts, which were designated as hedging instruments in cash flow hedges, was to hedge the quarterly interest payments on the Bancorp's \$119.1 million of Junior Subordinated Debentures that had been issued to five trusts, throughout the ten-year period beginning in June 2014 and ending in June 2024, from the risk of variability of these payments resulting from changes in the three-month LIBOR interest rate. The Bancorp pays a weighted average fixed interest rate of 2.61% and receives a variable interest rate of the three-month LIBOR at a weighted average rate of 2.33%. As of June 30, 2018, the notional amount of cash flow interest rate swaps was \$119.1 million and their unrealized gain of \$1.2 million, net of taxes, was included in other comprehensive income compared to unrealized loss of \$2.4 million at June 30, 2017. The amount of periodic net settlement of interest rate swaps included in interest expense was \$123,000 for the three months ended June 30, 2018, compared to \$439,000 for the same quarter a year ago. For the six months ended June 30, 2018, the periodic net settlement of interest rate swaps included in interest expense was \$396,000 compared to \$0.9 million for the same period in 2017. As of June 30, 2018, and 2017, the ineffective portion of these interest rates swaps was not significant.

As of June 30, 2018, the Bank's outstanding interest rate swap contracts had a notional amount of \$631.4 million for various terms from two to ten years. The Bank entered into these interest rate swap contracts that are matched to individual fixed-rate commercial real estate loans in the Bank's loan portfolio. These contracts have been designated as hedging instruments to hedge the risk of changes in the fair value of the underlying commercial real estate loans due to changes in interest rates. The swap contracts are structured so that the notional amounts reduce over time to match the contractual amortization of the underlying loan and allow prepayments with the same pre-payment penalty amounts as the related loan. The Bank pays a weighted average fixed rate of 4.7% and receives a variable rate of the one-month LIBOR rate plus a weighted average spread of 271 basis points, or at a weighted average rate of 4.7%. As of June 30, 2018, and June 30, 2017, the notional amount of fair value interest rate swaps was \$631.4 million and \$446.1 million with net unrealized gains of \$13.0 million and \$1.0 million, respectively, included in other non-interest income. The amount of periodic net settlement of interest rate swaps reducing interest income was zero for the three months ended June 30, 2018, compared to \$651,000 for the same quarter a year ago. The amount of periodic net settlement of interest rate swaps reducing interest income was \$229,000 for the six months ended June 30, 2018, compared to \$1.4 million for the same period a year ago. As of June 30, 2018, and 2017, the ineffective portion of these interest rate swaps was not significant.



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Interest rate swap contracts involve the risk of dealing with institutional derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have a strong credit profile and be approved by the Company's Board of Directors. The Company's credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty. Credit exposure may be reduced by the amount of collateral pledged by the counterparty. The Bancorp's interest rate swaps have been assigned by the counterparties to a derivatives clearing organization and daily margin is indirectly maintained with the derivatives clearing organization. Cash posted as collateral by the Bancorp related to derivative contracts totaled \$361,000 as of June 30, 2018 and \$4.5 million as of December 31, 2017.

The Company enters into foreign exchange forward contracts with various counterparties to mitigate the risk of fluctuations in foreign currency exchange rates for foreign exchange certificates of deposit or foreign exchange contracts entered into with our clients. These contracts are not designated as hedging instruments and are recorded at fair value in our Consolidated Balance Sheet. Changes in the fair value of these contracts as well as the related foreign exchange certificates of deposit and foreign exchange contracts are recognized immediately in net income as a component of non-interest income. Period end gross positive fair values are recorded in other assets and gross negative fair values are recorded in other liabilities. At June 30, 2018, the notional amount of option contracts totaled \$1.7 million with a net negative fair value of \$9,000. At June 30, 2018, spot, forward, and swap contracts in the total notional amount of \$62.7 million had a positive fair value of \$389,000. Spot, forward, and swap contracts in the total notional amount of \$92.7 million had a negative fair value of \$2.1 million at June 30, 2018. At December 31, 2017, the notional amount of option contracts totaled \$1.0 million with a net negative fair value of \$9,000. At December 31, 2017, spot, forward, and swap contracts in the total notional amount of \$108.5 million had a positive fair value of \$1.8 million. Spot, forward, and swap contracts in the total notional amount of \$32.1 million had a negative fair value of \$453,000 at December 31, 2017.

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**Liquidity**

Liquidity is our ability to maintain sufficient cash flow to meet maturing financial obligations and customer credit needs, and to take advantage of investment opportunities as they are presented in the marketplace. Our principal sources of liquidity are growth in deposits, proceeds from the maturity or sale of securities and other financial instruments, repayments from securities and loans, federal funds purchased, securities sold under agreements to repurchase, and advances from the FHLB. As of June 30, 2018, our average monthly liquidity ratio (defined as net cash plus short-term and marketable securities to net deposits and short-term liabilities) was 12.6% compared to 12.1% as of December 31, 2017.

The Bank is a shareholder of the FHLB, which enables the Bank to have access to lower-cost FHLB financing when necessary. At June 30, 2018, the Bank had an approved credit line with the FHLB of San Francisco totaling \$4.0 billion. Total advances from the FHLB of San Francisco were \$480.0 million and standby letter of credits issued by FHLB on the Company's behalf were \$161.2 million as of June 30, 2018. These borrowings bear fixed rates and are secured by loans. See Note 9 to the Consolidated Financial Statements. At June 30, 2018, the Bank pledged \$19.9 million of its commercial loans to the Federal Reserve Bank's Discount Window under the Borrower-in-Custody program. The Bank had borrowing capacity of \$16.5 million from the Federal Reserve Bank Discount Window at June 30, 2018.

Liquidity can also be provided through the sale of liquid assets, which consist of federal funds sold, securities purchased under agreements to resell, and securities available-for-sale. At June 30, 2018, investment securities totaled \$1.5 billion, with \$158.1 million pledged as collateral for borrowings and other commitments. The remaining \$1.3 billion was available as additional liquidity or to be pledged as collateral for additional borrowings.

Approximately 83% of our time deposits mature within one year or less as of June 30, 2018. Management anticipates that there may be some outflow of these deposits upon maturity due to the keen competition in the Bank's marketplace. However, based on our historical runoff experience, we expect the outflow will not be significant and can be replenished through our normal growth in deposits. Management believes all the above-mentioned sources will provide adequate liquidity during the next twelve months for the Bank to meet its operating needs.

The business activities of Bancorp consist primarily of the operation of the Bank and limited activities in other investments. The Bank paid dividends to Bancorp totaling \$72.4 million during the first six months of 2018 and \$208.2 million during 2017.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**



We use a net interest income simulation model to measure the extent of the differences in the behavior of the lending and funding rates to changing interest rates, so as to project future earnings or market values under alternative interest rate scenarios. Interest rate risk arises primarily through the Company's traditional business activities of extending loans and accepting deposits. Many factors, including economic and financial conditions, movements in interest rates, and consumer preferences affect the spread between interest earned on assets and interest paid on liabilities. The net interest income simulation model is designed to measure the volatility of net interest income and net portfolio value, defined as net present value of assets and liabilities, under immediate rising or falling interest rate scenarios in 100 basis point increments.

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Although we believe the modeling is helpful in managing interest rate risk, it does require significant assumptions for the projection of loan prepayment rates on mortgage related assets, loan volumes and pricing, and deposit and borrowing volume and pricing, that might prove inaccurate. Because these assumptions are inherently uncertain, the model cannot precisely estimate net interest income, or precisely predict the effect of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to the timing, magnitude, and frequency of interest rate changes, the differences between actual experience and the assumed volume, changes in market conditions, and management strategies, among other factors. The Company monitors its interest rate sensitivity and attempts to reduce the risk of a significant decrease in net interest income caused by a change in interest rates.

We have established a tolerance level in our policy to define and limit net interest income volatility to a change of plus or minus 5% when the hypothetical rate change is plus or minus 200 basis points. When the net interest rate simulation projects that our tolerance level will be met, or exceeded, we seek corrective action after considering, among other things, market conditions, customer reaction, and the estimated impact on profitability. The Company's simulation model also projects the net economic value of our portfolio of assets and liabilities. We have established a tolerance level in our policy to limit the loss in the net economic value of our portfolio of assets and liabilities to zero when the hypothetical rate change is plus or minus 200 basis points.

The table below shows the estimated impact of changes in interest rates on net interest income and market value of equity as of June 30, 2018:

| Change in Interest Rate (Basis Points) | Net<br>Interest<br>Income<br>Volatility<br>(1) | Market<br>Value<br>of Equity<br>Volatility<br>(2) |
|--|--|---|
| +200                                   | 7.7  | 2.4   |
| +100                                   | 3.9  | 1.4   |
| -100                                   | -7.1   | 1.2   |
| -200                                   | -17.3  | 1.6   |

(1) The percentage change in this column represents net interest income of the Company for 12 months in a stable interest rate environment versus the net interest income in the various rate scenarios.

(1) The percentage change in this column represents the net portfolio value of the Company in a stable interest rate environment versus the net portfolio value in the various rate scenarios.

#### Item 4. CONTROLS AND PROCEDURES.

The Company's principal executive officer and principal financial officer have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this quarterly report. Based upon their evaluation, the principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

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There has not been any change in our internal control over financial reporting that occurred during the second quarter of 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II – OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS.**

Bancorp's wholly-owned subsidiary, Cathay Bank, is a party to ordinary routine litigation from time to time incidental to various aspects of its operations. Management does not believe that any such litigation is expected to have a material adverse impact on the Company's consolidated financial condition or results of operations.

Table of Contents**Item 1A. RISK FACTORS.**

There is no material change in the risk factors as previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, in response to Item 1A in Part I of Form 10-K.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.****ISSUER PURCHASES OF EQUITY SECURITIES**

| <b>Period</b>                             | <b>(a) Total Number<br/>of<br/>Shares (or Units)<br/>Purchased</b> | <b>(b) Average<br/>Price Paid<br/>per Share<br/>(or Unit)</b> | <b>(c) Total<br/>Number<br/>of Shares (or<br/>Units)<br/>Purchased as<br/>Part of Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>(d) Maximum<br/>Number<br/>(or Approximate<br/>Dollar Value) of<br/>Shares (or Units) that<br/>May Yet Be<br/>Purchased Under the<br/>Plans or Programs</b> |
|---|--|---|--|--|
| Month #1 (April 1, 2018 - April 30, 2018) | 0  | \$0   | 0  | \$7,543,008  |
| Month #2 (May 1, 2018 - May 31, 2018)     | 0  | \$0   | 0  | \$7,543,008  |
| Month #3 (June 1, 2018 - June 30, 2018)   | 0  | \$0   | 0  | \$7,543,008  |
| Total                                     | 0  | \$0   | 0  | \$7,543,008  |

For a discussion of limitations on the payment of dividends, see “*Dividend Policy*” and “*Liquidity*” under Part I—Item 2—“Management’s Discussion and Analysis of Financial Condition and Results of Operations.”



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**Item 3. DEFAULTS UPON SENIOR SECURITIES.**

Not applicable.

**Item 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**Item 5. OTHER INFORMATION.**

None.

**Item 6. EXHIBITS.**

Exhibit 10.1 Amendment No. 3 to the Cathay Bank Employee Stock Ownership Plan, as amended and restated, effective December 22, 2015. \*\*+

Exhibit 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.+

Exhibit 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.+

Exhibit 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.++

Exhibit 32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.++

Exhibit 101.INS XBRL Instance Document \*

Exhibit 101.SCH XBRL Taxonomy Extension Schema Document\*

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document\*

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase Document\*

Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase Document\*

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document\*

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+Filed herewith.

++Furnished herewith.

XBRL (Extensible Business Reporting Language) information shall not be deemed to be filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, shall not be \*deemed to be filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise shall not be subject to liability under these sections, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, except as expressly set forth by specific reference in such filing.

\*\*Management contract or compensatory plan or arrangement.



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**SIGNATURES**

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

Cathay General Bancorp

(Registrant)

Date: August 8, 2018

/s/ Pin Tai  
Pin Tai  
Chief Executive Officer and President

Date: August 8, 2018

/s/ Heng W. Chen  
Heng W. Chen  
Executive Vice President and Chief  
Financial Officer