OLD NATIONAL BANCORP /IN/
Form 10-K
February 12, 2019

false 2018 FY ONB Old National Bancorp /IN/ 0000707179 --12-31 Yes Yes No Large Accelerated Filer false false false P15Y P3Y P5Y P1D P120D P1Y5M one year and five months. P5Y 2032-04-22 2037-06-15 P3Y 2019-01-31 2028-10-31 0 BBB 33 44 43 49 P2Y29D P2Y29D 0.042 0.096 0.073 0.000 0.000 0.000 0.042 0.096 0.075 0.000 0.041 0.006 0.35 0.35 0.15 0.49 0.32 0.18 0.00 0.00 0.15 0.00 0.10 0.07 0.90 0.50 0.16 0.98 0.78 0.25 0.39 2002-04-30 2002-10-31 2004-04-30 2005-03-31 2005-08-31 2005-12-31 2006-09-30 2006-07-31 2006-12-31 2007-03-31 0000707179 2018-01-01 2018-12-31 xbrli:shares 0000707179 2019-01-31 iso4217:USD 0000707179 2018-06-30 0000707179 2018-12-31 0000707179 2017-12-31 0000707179 us-gaap:SeriesAPreferredStockMember 2018-12-31 0000707179 us-gaap:SeriesAPreferredStockMember 2017-12-31 iso4217:USD xbrli:shares 0000707179 2017-01-01 2017-12-31 0000707179 2016-01-01 2016-12-31 0000707179 us-gaap:CommonStockMember 2015-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember 2015-12-31 0000707179 us-gaap:RetainedEarningsMember 2015-12-31 0000707179 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2015-12-31 0000707179 2015-12-31 0000707179 us-gaap:RetainedEarningsMember 2016-01-01 2016-12-31 0000707179 us-gaap:AccumulatedOtherComprehensiveIncomeMember onb:AnchorBankWiMember 2016-01-01 2016-12-31 0000707179 onb:AnchorBankWiMember 2016-01-01 2016-12-31 0000707179 us-gaap:CommonStockMember 2016-01-01 2016-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember 2016-01-01 2016-12-31 0000707179 us-gaap:CommonStockMember 2016-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember 2016-12-31 0000707179 us-gaap:RetainedEarningsMember 2016-12-31 0000707179 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2016-12-31 0000707179 2016-12-31 0000707179 us-gaap:RetainedEarningsMember 2017-01-01 2017-12-31 0000707179 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-01-01 2017-12-31 0000707179 us-gaap:CommonStockMember 2017-01-01 2017-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember 2017-01-01 2017-12-31 0000707179 us-gaap:CommonStockMember 2017-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember 2017-12-31 0000707179 us-gaap:RetainedEarningsMember 2017-12-31 0000707179 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-12-31 0000707179 us-gaap:RetainedEarningsMember 2018-01-01 2018-12-31 0000707179 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-01-01 2018-12-31 0000707179 us-gaap:CommonStockMember onb:MinnesotaBasedKleinMember 2018-01-01 2018-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember onb:MinnesotaBasedKleinMember 2018-01-01 2018-12-31 0000707179 onb:MinnesotaBasedKleinMember 2018-01-01 2018-12-31 0000707179 us-gaap:CommonStockMember 2018-01-01 2018-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember 2018-01-01 2018-12-31 0000707179 us-gaap:CommonStockMember 2018-12-31 0000707179 us-gaap:AdditionalPaidInCapitalMember 2018-12-31 0000707179 us-gaap:RetainedEarningsMember 2018-12-31 0000707179 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-12-31 0000707179 onb:AnchorBancorpIncMember stpr:MN 2018-01-01 2018-12-31 0000707179 stpr:MN onb:KleinFinancialIncMember 2018-01-01 2018-12-31 0000707179 us-gaap:JuniorSubordinatedDebtMember 2018-01-01 2018-12-31 0000707179 srt:MaximumMember 2018-01-01 2018-12-31 0000707179 srt:MinimumMember us-gaap:BuildingAndBuildingImprovementsMember 2018-01-01 2018-12-31 0000707179 srt:MaximumMember us-gaap:BuildingAndBuildingImprovementsMember 2018-01-01 2018-12-31 0000707179 srt:MinimumMember us-gaap:FurnitureAndFixturesMember 2018-01-01 2018-12-31 0000707179 srt:MaximumMember us-gaap:FurnitureAndFixturesMember 2018-01-01 2018-12-31 0000707179 onb:CoreDepositsAndOtherIntangibleAssetsMember srt:MinimumMember 2018-01-01 2018-12-31 0000707179 onb:CoreDepositsAndOtherIntangibleAssetsMember srt:MaximumMember 2018-01-01 2018-12-31 0000707179 srt:MinimumMember 2018-01-01 2018-12-31 0000707179 us-gaap:EmployeeStockOptionMember 2018-01-01 2018-12-31 0000707179 us-gaap:EmployeeStockOptionMember 2017-01-01 2017-12-31 0000707179 us-gaap:EmployeeStockOptionMember 2016-01-01 2016-12-31 xbrli:pure 0000707179 onb:AnchorBankMnMember us-gaap:CommonStockMember 2017-01-01 2017-12-31 0000707179 onb:AnchorBankWiMember us-gaap:CommonStockMember 2016-01-01 2016-12-31 0000707179 onb:AnchorBankMnMember 2017-01-01 2017-12-31 0000707179 us-gaap:AccountingStandardsUpdate201616Member 2018-01-02 0000707179

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2018

Commission File Number 1-15817

OLD NATIONAL BANCORP

(Exact name of the Registrant as specified in its charter)

INDIANA	35-1539838
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	Identification No.)

One Main Street

Evansville, Indiana	47708
(Address of principal executive offices)	(Zip Code)

(800) 731-2265

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of each exchange on which registered
Common Stock, No Par Value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (s232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (s229.405 of this chapter) is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

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

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

The aggregate market value of the registrant’s voting common stock held by non-affiliates on June 30, 2018, was $2,791,017,355 (based on the closing price on that date of $18.60). In calculating the market value of securities held by non-affiliates of the registrant, the registrant has treated as securities held by affiliates as of June 30, 2018, voting stock owned of record by its directors and principal executive officers, and voting stock held by the registrant's trust department in a fiduciary capacity for benefit of its directors and principal executive officers. This calculation does not reflect a determination that persons are affiliates for any other purposes.

The number of shares outstanding of the registrant's common stock, as of January 31, 2019, was 175,163,000.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held May 2, 2019 are incorporated by reference into Part III of this Form 10-K.

OLD NATIONAL BANCORP

2018 ANNUAL REPORT ON FORM 10-K

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GLOSSARY OF ABBREVIATIONS AND ACRONYMS

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

The acronyms and abbreviations identified below are used throughout this report, including the Notes to Consolidated Financial Statements. You may find it helpful to refer to this page as you read this report.

ACH: Automated Clearing House

Anchor (MN): Anchor Bancorp, Inc.

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

Anchor (WI): Anchor BanCorp Wisconsin Inc.

AnchorBank (WI): AnchorBank, fsb

AOCI: accumulated other comprehensive income (loss)

AQR: asset quality rating

ASC: Accounting Standards Codification

ASU: Accounting Standards Update

ATM: automated teller machine

CDO: collateralized debt obligation

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

CReED: Indiana Community Revitalization Enhancement District Tax Credit

DTI: debt-to-income

EITF: Emerging Issues Task Force

FASB: Financial Accounting Standards Board

FDIC: Federal Deposit Insurance Corporation

FHLB: Federal Home Loan Bank

FHLBI: Federal Home Loan Bank of Indianapolis

FHTC: Federal Historic Tax Credit

FICO: Fair Isaac Corporation

GAAP: U.S. generally accepted accounting principles

Klein: Klein Financial, Inc.

LGD: loss given default

LIBOR: London Interbank Offered Rate

LIHTC: Low Income Housing Tax Credit

LTV: loan-to-value

N/A: not applicable

N/M: not meaningful

NASDAQ: The NASDAQ Stock Market LLC

NOW: negotiable order of withdrawal

OCC: Office of the Comptroller of the Currency

ONI: ONB Insurance Group, Inc.

OTTI: other-than-temporary impairment

PCI: purchased credit impaired

PD: probability of default

PSA: prepayment speed assumptions

Renewable Energy: investment tax credits for solar projects

SAB: Staff Accounting Bulletin

SEC: Securities and Exchange Commission

TBA: to be announced

TDR: troubled debt restructuring

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OLD NATIONAL BANCORP

2018 ANNUAL REPORT ON FORM 10-K

FORWARD-LOOKING STATEMENTS

In this report, we have made various statements regarding current expectations or forecasts of future events, which speak only as of the date the statements are made. These statements are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are also made from time-to-time in press releases and in oral statements made by the officers of Old National Bancorp ("Old National" or the "Company"). Forward-looking statements can be identified by the use of the words "expect," "may," "could," "intend," "project," "estimate," "believe," "anticipate," and other words of similar meaning. Forward-looking statements also include, but are not limited to, statements regarding estimated cost savings, plans and objectives for future operations, the Company's business and growth strategies, including future acquisitions of banks, regulatory developments, and expectations about performance as well as economic and market conditions and trends.

Such forward-looking statements are based on assumptions and estimates, which although believed to be reasonable, may turn out to be incorrect. Therefore, undue reliance should not be placed upon these estimates and statements. We cannot assure that any of these statements, estimates, or beliefs will be realized and actual results may differ from those contemplated in these "forward-looking statements." We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or otherwise. You are advised to consult further disclosures we may make on related subjects in our filings with the SEC. In addition to other factors discussed in this report, some of the important factors that could cause actual results to differ materially from those discussed in the forward-looking statements include the following:

- economic, market, operational, liquidity, credit, and interest rate risks associated with our business;
- economic conditions generally and in the financial services industry;
- expected cost savings in connection with the consolidation of recent acquisitions may not be fully realized or realized within the expected time frames, and deposit attrition, customer loss, and revenue loss following completed acquisitions may be greater than expected;
- failure to properly understand risk characteristics of newly entered markets;
- increased competition in the financial services industry either nationally or regionally, resulting in, among other things, credit quality deterioration;
- our ability to achieve loan and deposit growth;
- volatility and direction of market interest rates;
- governmental legislation and regulation, including changes in accounting regulation or standards;
- our ability to execute our business plan;
- a weakening of the economy which could materially impact credit quality trends and the ability to generate loans;
- changes in the securities markets; and
- changes in fiscal, monetary, and tax policies.

Investors should consider these risks, uncertainties, and other factors in addition to risk factors included in this filing and our other filings with the SEC.

PART I

ITEM 1. BUSINESS
GENERAL

Old National is a financial holding company incorporated in the state of Indiana and maintains its principal executive office in Evansville, Indiana. We, through our wholly-owned banking subsidiary, provide a wide range of services, including commercial and consumer loan and depository services, private banking, brokerage, trust, investment advisory, and other traditional banking services. At December 31, 2018, we employed 2,892 full-time equivalent associates.

COMPANY PROFILE

Old National Bank, our wholly-owned banking subsidiary ("Old National Bank"), was founded in 1834 and is the oldest company in Evansville, Indiana. In 1982, Old National Bancorp was formed; in 2001 we became a financial holding company and we are currently the largest financial holding company headquartered in the state of Indiana with consolidated assets of $19.7 billion at December 31, 2018.

At December 31, 2018, Old National Bank operated 191 banking centers located primarily in Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. Each of the branches of Old National Bank provide a group of similar community banking services, including such products and services as commercial, real estate and consumer loans, time deposits, checking and savings accounts, cash management, brokerage, trust, and investment advisory services. The individual bank branches located throughout our Midwest footprint have similar operating and economic characteristics.

We earn interest income on loans as well as fee income from the origination of loans. Lending activities include loans to individuals, which primarily consist of home equity lines of credit, residential real estate loans and consumer loans, and loans to commercial clients, which include commercial loans, commercial real estate loans, letters of credit, and lease financing. Residential real estate loans are either kept in our loan portfolio or sold to secondary investors, with gains or losses from the sales being recognized.

We strive to serve individuals and commercial clients by providing depository services that fit their needs at competitive rates. We pay interest on the interest-bearing deposits and receive service fee revenue on various accounts. Deposit accounts include products such as noninterest-bearing demand, interest-bearing checking and NOW, savings and money market, and time deposits. Debit and ATM cards provide clients with access to their accounts 24 hours a day at any ATM location. We also provide 24-hour telephone access and online banking as well as other electronic and mobile banking services.

In addition to the community banking services of lending and providing deposit services, we offer comprehensive wealth management, investment, and foreign currency services. For businesses, we provide treasury management, merchant, health savings, and capital markets services as well as community development lending and equity investment solutions that produce jobs and revitalize our communities.

MARKET AREA

We own the largest Indiana-based bank headquartered in Indiana. Operating from a home base in Evansville, Indiana, we have continued to grow our footprint in Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. Since the beginning of 2011, Old National has transformed its franchise by reducing low-return businesses and low-growth markets and investing in higher-growth markets.

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The following table reflects information on the top markets we currently serve, demonstrating that our largest metropolitan statistical areas compare favorably to the national average.

Metropolitan Statistical Area	Percent of Old National Bank Franchise (%)	Deposits Per Branch ($M)	2010-2019 Population Change (%)	2019-2024 Projected Population Change (%)	2019 Median Household Income ($)	2019-2024 Projected Household Income Change (%)
Minneapolis-St. Paul-Bloomington, MN-WI (1)	22.9	89.7	9.2	4.6	80,054	10.7
Evansville, IN-KY	14.2	117.6	1.5	1.3	53,807	10.4
Indianapolis-Carmel-Anderson, IN	8.0	53.6	9.1	3.9	62,642	10.9
Madison, WI (1)	5.8	48.3	9.8	4.0	74,588	13.0
Bloomington, IN (1)	4.9	138.6	6.3	3.2	48,854	12.5
Fort Wayne, IN (1)	3.5	99.6	5.4	3.0	56,723	10.1
Jasper, IN	2.8	78.7	0.4	1.1	61,313	7.1
Terre Haute, IN	2.7	76.5	(1.7)	0.1	48,262	10.3
Adrian, MI (1)	2.2	78.6	(1.3)	0.0	57,884	14.5
Ann Arbor, MI (1)	2.1	58.1	8.0	3.2	72,826	12.3
National average			6.6	3.6	63,174	8.8
Weighted average or sum total						
Old National Bank top 5	55.7	82.0	8.8	4.2	63,989	11.5
Weighted average or sum total						
Old National Bank top 10	69.0	81.2	8.2	3.9	61,695	11.2
(1) Expansion markets weighted average	41.4	81.2	8.6	4.2	65,155	12.1
Weighted average total Old National Bank			4.6	2.5	62,633	10.4

Source: S&P Global Market Intelligence

ACQUISITION AND DIVESTITURE STRATEGY

Since the formation of Old National in 1982, we have acquired over 50 financial institutions and other financial services businesses. Future acquisitions and divestitures will be driven by a disciplined financial evaluation process and will be consistent with the existing basic banking strategy which focuses on community banking, client relationships, and consistent quality earnings. Targeted geographic markets for acquisitions include mid-size markets with average to above average growth rates.

We anticipate that, as with previous acquisitions, the consideration paid by us in future acquisitions may be in the form of cash, debt, or Old National stock, or a combination thereof. The amount and structure of such consideration is

based on reasonable growth and cost savings assumptions and a thorough analysis of the impact on both long- and short-term financial results.

Effective November 1, 2018, Old National acquired Minnesota-based Klein through a 100% stock merger. Klein was a bank holding company with KleinBank as its wholly-owned subsidiary. Founded in 1907 and headquartered in Chaska, Minnesota with 18 full-service branches, KleinBank was the largest family-owned community bank serving the Twin Cities and its western communities. Pursuant to the merger agreement, each holder of Klein common stock received 7.92 shares of Old National Common Stock per share of Klein common stock such holder owned. The total fair value of consideration for Klein was $406.5 million, consisting of 22.8 million shares of Old National Common Stock valued at $406.5 million. See Note 2 to the consolidated financial statements for further details on the Klein acquisition.

Prior to 2018, our most recent acquisitions included the following:

- Indiana bank holding company Tower Financial Corporation through a stock and cash merger on April 25, 2014 that added seven full-service branches in the Fort Wayne, Indiana market and strengthened Old National's position as one of the largest deposit holders in Indiana;
- Michigan bank holding company United Bancorp, Inc. through a stock and cash merger on July 31, 2014 that added 18 branches in Ann Arbor, Michigan and the surrounding area, doubling our presence in Michigan;
- LSB Financial Corp. through a stock and cash merger on November 1, 2014 that added five branches in Lafayette, Indiana;
- Michigan-based Founders Financial Corporation through a stock and cash merger on January 1, 2015 that added four branches in the Grand Rapids, Michigan market;
- Anchor BanCorp Wisconsin Inc. through a stock and cash merger on May 1, 2016 that added 46 branches in the Madison, Milwaukee, and Fox Valley triangle markets; and
- Anchor Bank, N.A through a stock and cash merger on November 1, 2017 that added 17 branches in Minnesota.

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

Divestitures

On August 14, 2015, Old National divested its southern Illinois region (twelve branches) along with four branches in eastern Indiana and one in Ohio. At closing, the purchasers assumed loans of $193.6 million and deposits of $555.8 million. Old National recorded a net pre-tax gain of $15.6 million in connection with the divestitures, which included a deposit premium of $19.3 million, goodwill allocation of $3.8 million, and $0.9 million of other transaction expenses.

On May 31, 2016, the Company sold its insurance operations, ONI. The Company received approximately $91.8 million in cash resulting in a pre-tax gain of $41.9 million and an after-tax gain of $17.6 million. See Note 16 to the consolidated financial statements for further details on the income tax impact of this sale. Goodwill and intangible assets of approximately $47.5 million were eliminated as part of this transaction. ONI was an ancillary business and did not meet the criteria to be treated as a discontinued operation as defined in Accounting Standards Update 2014-08, *"Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity."*

On October 26, 2018, the Company divested ten branches in Wisconsin to Marine Credit Union of La Crosse, Wisconsin. At closing, the purchasers assumed $230.6 million in deposits and no loans. Old National recorded a net pre-tax gain of $14.0 million in connection with the sale, which included a deposit premium of $15.0 million, goodwill allocation of $0.6 million, and $0.4 million of other transaction expenses.

We continue to focus our efforts to optimize our branch network. Since the beginning of 2011, we have consolidated 158 banking centers (including 10 banking centers in 2018). Over the same period, we have more than doubled our assets and have increased our average total deposits per branch from $34 million to approximately $75 million, while only increasing our number of branches by 30. We will continue to review our branch system as we adapt to client behavior changes, continue to make technology improvements, and delivery model changes. Accordingly, as a result of our ongoing branch analysis, we expect a continued reduction in our branch network in 2019.

COMPETITION

The banking industry and related financial service providers operate in a highly competitive market. Old National competes with financial service providers such as other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds, and other financial intermediaries. In addition, Financial Technology, or FinTech, start-ups are emerging in key areas of banking.

Many of our nonfinancial institution competitors have fewer regulatory constraints, broader geographic service areas, greater capital, and, in some cases, lower cost structures. In addition, competition for quality customers has

intensified as a result of changes in regulation, mergers and acquisitions, advances in technology and product delivery systems, consolidation among financial service providers, bank failures, and the conversion of certain former investment banks to bank holding companies.

SUPERVISION AND REGULATION

Old National is subject to extensive regulation under federal and state laws. The regulatory framework is intended primarily for the protection of depositors, federal deposit insurance funds, and the banking system as a whole and not for the protection of shareholders and creditors.

Significant elements of the laws and regulations applicable to Old National and its subsidiaries are described below. The descriptions are not intended to be complete and are qualified in its entirety by reference to the full text of the statutes, regulations and policies that are described. Also, such statutes, regulations and policies are continually under review by Congress and state legislatures and federal and state regulatory agencies. A change in statutes, regulations, or regulatory policies applicable to Old National and its subsidiaries, for which Old National cannot predict, could have a material effect on the business of the Company.

The Dodd-Frank Act. On July 21, 2010, financial regulatory reform legislation entitled the “Dodd-Frank Wall Street Reform and Consumer Protection Act” (the “Dodd-Frank Act”) was signed into law. The Dodd-Frank Act significantly restructured the financial regulatory environment in the United States. The Dodd-Frank Act contains numerous provisions that affect all bank holding companies and banks, including Old National and Old National Bank, some of which are described in more detail below. The scope and impact of many of the Dodd-Frank Act provisions were determined and issued over time. The impact of the Dodd-Frank Act on Old National has been substantial. Provisions in the legislation that affect the payment of interest on demand deposits and collection of interchange fees increased the costs associated with certain deposits and placed limitations on certain revenues those deposits generate.

The Volcker Rule. Section 619 of the Dodd-Frank Act contains provisions prohibiting proprietary trading and restricting the activities involving private equity and hedge funds (the “Volcker Rule”). Rules implementing the Volcker Rule were adopted in December 2013. Proprietary trading is defined as the trading of securities, derivatives, or futures (or options on any of the foregoing) as principal, where such trading is principally for the purpose of short-term resale, benefiting from actual or expected short-term price movements and realizing short-term arbitrage profits. The rule’s definition of proprietary trading specifically excludes market-making-related activity, certain government issued securities trading and certain risk management activities. Old National and Old National Bank do not engage in any prohibited proprietary trading activities.

The final text of the Volcker Rule contained provisions to the effect that CDOs, including pooled trust preferred securities, would have to be sold prior to July 15, 2015. The practical implication of this rule provision, which was not expected by the industry, was that those instruments could no longer be accorded “held-to-maturity” accounting treatment but would have to be switched to “available-for-sale” accounting, and that all covered CDOs, regardless of the accounting classification, would need to be adjusted to fair value through an other-than-temporary impairment non-cash charge to earnings. On January 14, 2014, federal banking agencies released an interim final rule regarding the Volcker Rule’s impact on trust preferred CDOs, which included a nonexclusive list of CDOs backed by trust preferred securities that depository institutions will be permitted to continue to hold. All of the trust preferred securities owned by Old National are on this list and held as “available-for-sale”. Any unrealized losses associated with these instruments have already impacted our capital. As of December 31, 2018, Old National does not have any securities that will have to be divested as a result of the Volcker Rule.

Bank Holding Company Regulation. Old National is registered as a bank holding company and has elected to be a financial holding company. It is subject to the supervision of, and regulation by, the Board of Governors of the

Federal Reserve System (the “Federal Reserve”) under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Federal Reserve has issued regulations under the BHC Act requiring a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the policy of the Federal Reserve that, pursuant to this requirement, a bank holding company should stand ready to use its resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity. Under this requirement, Old National is expected to commit resources to support Old National Bank, including at times when Old National may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to depositors and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company’s bankruptcy, any commitment by the bank holding

company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

The BHC Act requires the prior approval of the Federal Reserve to acquire more than a 5% voting interest of any bank or bank holding company. Additionally, the BHC Act restricts Old National's non-banking activities to those which are determined by the Federal Reserve to be closely related to banking and a proper incident thereto.

Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become "undercapitalized" (as defined in FDICIA) with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal bank regulatory agency.

Capital and Liquidity Requirements. Bank holding companies are required to comply with the Federal Reserve's risk-based capital guidelines. The FDIC and the OCC have adopted risk-based capital ratio guidelines to which depository institutions under their respective supervision, including Old National Bank, are subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk-weighted categories, with higher levels of capital being required for the categories perceived as representing greater risk. Old National Bank exceeded all risk-based minimum capital requirements of the FDIC and OCC as of December 31, 2018 and 2017. For Old National's regulatory capital ratios and regulatory requirements as of December 31, 2018 and 2017, see Note 25 to the consolidated financial statements.

The federal regulatory authorities' current risk-based capital guidelines are based upon the Basel Committee on Banking Supervision (the "Basel Committee"). The Basel Committee is a committee of international central banks and bank regulators responsible for establishing international supervisory guidelines for use in member jurisdictions to enhance and align bank regulation on a global scale and promote financial stability. In December 2010 and January 2011, the Basel Committee published the final revisions to the international regulatory capital framework generally referred to as "Basel III," as a response to deficiencies in the international regulatory standards identified during the global financial crisis.

Effective July 2, 2013, the Federal Reserve and the OCC approved final rules known as the "Basel III Capital Rules" substantially revising the risk-based capital and leverage capital requirements applicable to bank holding companies and depository institutions, including Old National and Old National Bank. The Basel III Capital Rules address the components of capital and other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules. Certain of the Basel III Capital Rules came into effect for Old National and Old National Bank on January 1, 2015; subject to a phase-in period ending on December 31, 2018.

The Basel III Capital Rules introduced a new capital measure "Common Equity Tier 1" ("CET1"). The rules specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements. CET1 capital consists of common stock instruments that meet the eligibility criteria in the final rules, retained earnings, accumulated other comprehensive income, and common equity Tier 1 minority interest. The rules also define CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1, and not to the other components of capital. They also expand the scope of the adjustments as compared to existing regulations.

As of January 1, 2019, the Basel III Capital Rules require banking organizations to maintain:

- a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased-in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7.0% upon full implementation);
- a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased-in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation);
- a minimum ratio of total capital (that is, Tier 1 plus Tier 2 capital) to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased-in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and
- a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to adjusted average consolidated assets.

The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will face limitations on the payment of dividends, common stock repurchases and discretionary cash payments to executive officers based on the amount of the shortfall.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under current capital standards, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under the Basel III Capital Rules, Old National and Old National Bank are given a one-time election (the "Opt-out Election") to filter certain AOCI components, comparable to the treatment under the current general risk-based capital rule. The Company chose the Opt-out Election on the March 31, 2015 Call Report and FR Y-9C for Old National Bank and Old National, respectively.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and have been phased-in over a five-year period (20% per year). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and was phased-in over a four-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019).

The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and is not expected to have any current applicability to Old National or Old National Bank.

In addition, the Basel III Capital Rules revise the rules for calculating risk-weighted assets to enhance their risk sensitivity. They establish a new framework under which mortgage-backed securities and other securitization exposures will be subject to risk-weights ranging from 20% to 1,250%. The rules also establish adjusted risk-weights for credit exposures, including multi-family and commercial real estate exposures that are 90 days or more past due or on non-accrual, which will be subject to a 150% risk-weight, except in situations where qualifying collateral and/or guarantees are in place. The existing treatment of residential mortgage exposures will remain subject to either a 50% risk-weight (for prudently underwritten owner-occupied first liens that are current or less than 90 days past due) or a 100% risk-weight (for all other residential mortgage exposures including 90 days or more past due exposures).

Management believes that, as of December 31, 2018, Old National and Old National Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis if such requirements were currently effective. Requirements to maintain higher levels of capital or to maintain higher levels of liquid assets could adversely impact the Company's net income.

The Basel III Capital Rules permit banks with less than $15 billion in assets to continue to treat trust preferred securities as Tier 1 capital. This treatment is permanently grandfathered as Tier 1 capital for organic growth but not as a result of a merger or acquisition. On November 1, 2017, Old National acquired Anchor (MN) and exceeded $15 billion in assets. As the result of this acquisition, Tier 1 treatment of trust preferred securities is prohibited and those securities can only be treated as Tier 2 capital. The Basel III Capital Rules also permit banks with less than $250 billion in assets to choose to continue excluding unrealized gains and losses on certain securities holdings for purposes of calculating regulatory capital. As previously reported, the Old National chose the Opt-out Election in its

March 31, 2015 Call Report. Additionally, the Basel III Capital Rules limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of a specified amount of CET1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements.

The liquidity framework under the Basel III Capital Rules (the "Basel III liquidity framework") applies a balance sheet perspective to establish quantitative standards designed to ensure that a banking organization is appropriately positioned to satisfy its short- and long-term funding needs. One test to address short-term liquidity risk is referred to as the liquidity coverage ratio ("LCR"), designed to calculate the ratio of a banking entities' ratio of high-quality liquid assets to its total net cashflows over a 30-day time horizon. The other test, referred to as the net stable funding ratio ("NSFR"), is designed to promote more medium- and long-term asset funding by incenting banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt, as well as increase the use of long-term debt as a funding source. The Basel III liquidity framework was implemented as a minimum standard on January 1, 2015, with a phase-in period ending January 1, 2019. However, the federal banking agencies have not proposed rules implementing the Basel III liquidity framework and have not determined to what extent they will apply to U.S. banks that are not large, internationally active banks.

Management believes that, as of December 31, 2018, Old National Bank would meet the LCR requirement under the Basel III liquidity framework on a fully phased-in basis if such requirements were currently effective. Management's evaluation of the impact of the NSFR requirement is ongoing as of December 31, 2018. Requirements to maintain higher levels of liquid assets could adversely impact the Company's net income.

Prompt Corrective Action Regulations. The Federal Deposit Insurance Act (the "FDIA") requires, among other things, federal bank regulatory authorities to take "prompt corrective action" with respect to banks which do not meet minimum capital requirements. Under current prompt corrective action regulations, a bank will be (i) "well capitalized" if the institution has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) "adequately capitalized" if the institution has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, and a leverage ratio of 4.0% or greater and is not "well capitalized"; (iii) "undercapitalized" if the institution has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 4.0%; (iv) "significantly undercapitalized" if the institution has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0% or a leverage ratio of less than 3.0%; and (v) "critically undercapitalized" if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

The Basel III Capital Rules revised the "prompt corrective action" regulations pursuant to Section 38 of the FDIA, by:

- introducing a CET1 ratio requirement at each level (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status;
- increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 risk-based capital ratio for well-capitalized status being 8.0% (as compared to the previous 6.0%); and
- eliminating the provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% leverage ratio and still be well-capitalized.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be "undercapitalized." "Undercapitalized" institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan. The bank holding company must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to

the lesser of (i) an amount equal to 5.0% of the depository institution's total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized."

"Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

Management believes that, as of December 31, 2018, Old National Bank was "well capitalized" based on the existing ratios and the ratios as modified by the Basel III Capital Rules.

Deposit Insurance. Substantially all of the deposits of Old National Bank are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC and Old National Bank is subject to deposit insurance assessments to maintain the DIF. Deposit insurance assessments are based on average consolidated total assets minus average tangible equity. Under the FDIC's risk-based assessment system, insured institutions with at least $10 billion in assets, such as Old National Bank, are assessed on the basis of a scoring system that combines the institution's regulatory ratings and certain financial measures. The scoring system assesses risk measures to produce two scores, a performance score and a loss severity score, that will be combined and converted to an initial assessment rate.

The performance score measures an institution's financial performance and its ability to withstand stress. The loss severity score quantifies the relative magnitude of potential losses to the FDIC in the event of an institution's failure. Once the performance and loss severity scores are calculated, these scores will be converted to a total score. An institution with a total score of 30 or less will pay the minimum base assessment rate, and an institution with a total score of 90 or more will pay the maximum initial base assessment rate. For total scores between 30 and 90, initial base assessment rates will rise at an increasing rate as the total score increases. The FDIC has the authority to raise or lower assessment rates, subject to limits, and to impose special additional assessments.

Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Safety and Soundness Regulations. In accordance with the FDIA, the federal banking agencies adopted guidelines establishing general standards relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, regulations adopted by the federal banking agencies authorize the agencies to require that an institution that has been given notice that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, the institution fails to submit an acceptable compliance plan or fails in any material respect to implement an accepted compliance plan, the agency must issue an order directing corrective actions and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the "prompt corrective action" provisions of FDIA. If the institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Incentive Compensation. The Dodd-Frank Act requires the federal bank regulatory agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities having at least $1 billion in total assets, such as Old National and Old National Bank, that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011, but the regulations have not been finalized. If the regulations are adopted in the form initially proposed, they will impose limitations on the manner in which Old National may structure compensation for its executives.

In June 2010, the Federal Reserve, OCC, and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees who have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. These three principles are incorporated into the proposed joint compensation regulations under the Dodd-Frank Act, discussed above.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as Old National, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions.

Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Loans to One Borrower. Old National Bank generally may not make loans or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, up to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2018, Old National Bank was in compliance with the loans-to-one-borrower limitations.

Depositor Preference. The FDIA provides that, in the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including depositors whose deposits are payable only outside of the United States and the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

Community Reinvestment Act. The Community Reinvestment Act of 1977 ("CRA") requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings that must be publicly disclosed. In order for a financial holding company to commence any new activity permitted by the BHC Act, or to acquire any company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least "satisfactory" in its most recent examination under the CRA. Furthermore, banking regulators take into account CRA ratings when considering approval of certain applications. Old National Bank received a rating of "satisfactory" in its latest CRA examination.

Fair Lending Laws. Fair Lending laws prohibit discrimination in banking services and include the Equal Credit Opportunity Act ("ECOA") and the Fair Housing Act ("FHA"), which prohibit discrimination on the basis of race, gender,

religion, or other prohibited factors in the extension of credit and residential real estate transactions. In May 2018, the U.S. Department of Justice ("DOJ") and KleinBank entered into a public Settlement Agreement ("Agreement") regarding alleged violations of the FHA and the ECOA within the Minneapolis, Minnesota market. Old National Bank, as the legal successor in interest to KleinBank, has assumed the ongoing terms and obligations of the Agreement.

Financial Privacy. The federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Old National Bank is also subject to regulatory guidelines establishing standards for safeguarding customer information. These guidelines describe the federal banking agencies' expectations for the creation, implementation and maintenance of an information security program, which would include administrative, technical and physical safeguards appropriate to the size and complexity of the institution and the nature and scope of its activities. The standards set forth in the guidelines are intended to ensure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of such records and protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer.

Anti-Money Laundering and the USA Patriot Act. A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA Patriot Act of 2001 (the "USA Patriot Act") substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations on financial institutions, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States.

On May 11, 2016, the Financial Crimes Enforcement Network (the "FinCEN") issued new anti-money laundering ("AML") rules governing corporate entities doing business with banks and other financial institutions that are subject to the requirements of the USA Patriot Act. The new rules were effective May 11, 2018 which impose significant due diligence obligations on financial institutions with respect to opening of new accounts and the monitoring of existing accounts. Under the AML rules, a financial institution must identify persons owning or controlling 25% or more of a "legal entity," whenever the legal entity opens a new account at the bank. The financial institution must also identify an individual who has substantial management authority at the legal entity, such as a CEO, CFO, or managing partner.

The AML rules codify within the FinCEN regulations the "pillars" that must be included in a financial institutions AML compliance program. Regulators previously communicated their expectations with respect to four of these pillars: (1) the development of internal policies, procedures, and control; (2) the designation of a compliance officer; (3) the establishment of an ongoing employee training program; and (4) the implementation of an independent audit function to test programs. The new beneficial ownership requirement establishes a fifth pillar. Among other things, this new pillar includes the necessity to monitor and update the beneficial ownership of a legal entity, including the need to subject corporate borrowers to due diligence requests from financial institutions for certifications with respect to their beneficial owners. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Office of Foreign Assets Control Regulation. The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others which are administered by the U.S. Treasury Department Office of Foreign Assets Control. Failure to comply with these sanctions could have serious legal and reputational consequences, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Transactions with Affiliates. Transactions between Old National Bank and its affiliates are regulated by the Federal Reserve under sections 23A and 23B of the Federal Reserve Act and related regulations. These regulations limit the types and amounts of covered transactions engaged in by Old National Bank and generally require those transactions to be on an arm's-length basis. The term "affiliate" is defined to mean any company that controls or is under common control with Old National Bank and includes Old National and its non-bank subsidiaries. "Covered transactions" include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the Federal Reserve) from the affiliate, certain derivative transactions that create a credit exposure to an affiliate, the acceptance of securities issued by the affiliate as

collateral for a loan, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. In general, these regulations require that any such transaction by Old National Bank (or its subsidiaries) with an affiliate must be secured by designated amounts of specified collateral and must be limited to certain thresholds on an individual and aggregate basis.

Federal law also limits Old National Bank's authority to extend credit to its directors, executive officers and 10% shareholders, as well as to entities controlled by such persons. Among other things, extensions of credit to insiders are required to be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons. Also, the terms of such extensions of credit may not involve more than the normal risk of repayment or present other unfavorable features and may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of Old National Bank's capital.

Federal Home Loan Bank System. Old National Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions. As a member of the FHLBI, Old National Bank is required to acquire and hold shares of capital stock of the FHLBI in an amount at least equal to the sum of the membership stock purchase requirement, determined on an annual basis at the end of each calendar year, and the activity-based stock purchase requirement, determined on a daily basis. For Old National Bank, the membership stock purchase requirement is 1.0% of the Mortgage-Related Assets, as defined by the FHLBI, which consists principally of residential mortgage loans and mortgage-backed securities, held by Old National Bank. The activity-based stock purchase requirement is equal to the sum of: (1) a specified percentage ranging from 2.0% to 5.0%, which for Old National Bank is 5.0%, of outstanding borrowings from the FHLBI; (2) a specified percentage ranging from 0.0% to 5.0%, which for Old National Bank is 3.0%, of the outstanding principal balance of Acquired Member Assets, as defined by the FHLBI, and delivery commitments for Acquired Member Assets; (3) a specified dollar amount related to certain off-balance sheet items, which for Old National Bank is inapplicable; and (4) a specified percentage ranging from 0.0% to 5.0% of the carrying value on the FHLBI's balance sheet of derivative contracts between the FHLBI and Old National Bank, which for Old National Bank is inapplicable. The FHLBI can adjust the specified percentages and dollar amount from time to time within the ranges established by the FHLBI capital plan. As of December 31, 2018, Old National Bank was in compliance with the minimum stock ownership requirement.

Federal Reserve System. Federal Reserve regulations require depository institutions to maintain cash reserves against their transaction accounts (primarily NOW and demand deposit accounts). A reserve of 3% is to be maintained against aggregate transaction accounts between $12.4 million and $79.5 million (subject to adjustment by the Federal Reserve) plus a reserve of 10% (subject to adjustment by the Federal Reserve between 8% and 14%) against that portion of total transaction accounts in excess of $79.5 million. The first $12.4 million of otherwise reservable balances (subject to adjustment by the Federal Reserve) is exempt from the reserve requirements. Old National Bank is in compliance with the foregoing requirements.

Other Regulations. Old National Bank is subject to federal consumer protection statutes and regulations promulgated under those laws, including, but not limited to, the:

- Truth-In-Lending Act and Regulation Z, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act and Regulation C, requiring financial institutions to provide certain information about home mortgage and refinanced loans;
- Fair Credit Reporting Act and Regulation V, governing the provision of consumer information to credit reporting agencies and the use of consumer information;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Truth in Savings Act and Regulation DD, which requires disclosure of deposit terms to consumers;

- Regulation CC, which relates to the availability of deposit funds to consumers;
- Right to Financial Privacy Act, which imposes a duty to maintain the confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- Electronic Funds Transfer Act, governing automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

The Dodd-Frank Act also significantly impacts the various consumer protection laws, rules and regulations applicable to financial institutions. The statute rolls back the federal preemption of state consumer protection laws that was enjoyed by national banks by (1) requiring that a state consumer financial law prevent or significantly interfere with the exercise of a national bank's powers before it can be preempted, (2) mandating that any preemption decision be made on a case by case basis rather than a blanket rule, and (3) ending the applicability of preemption to subsidiaries and affiliates of national banks. As a result, we may now be subject to state consumer protection laws in each state where we do business, and those laws may be interpreted and enforced differently in each state.

The Dodd-Frank Act also created the Consumer Financial Protection Bureau (the "CFPB"), a consumer financial services regulator with supervisory authority over banks and their affiliates with assets of more than $10 billion, like Old National, to carry out federal consumer protection laws. The CFPB also regulates financial products and services sold to consumers and has rulemaking authority with respect to federal consumer financial laws. Any new regulatory requirements promulgated by the CFPB or modifications in the interpretations of existing regulations could require changes to Old National's consumer-facing businesses. The Dodd-Frank Act also gives the CFPB broad data collecting powers for fair lending for both small business and mortgage loans, as well as extensive authority to prevent unfair, deceptive, and abusive practices.

The rules issued by the CFPB have impacted our mortgage loan origination and servicing activities. Compliance with these rules will likely continue to increase our overall regulatory compliance costs.

Dividend Limitation. Old National Bank is subject to the provisions of the National Bank Act, is supervised, regulated and examined by the OCC, and is subject to the rules and regulations of the OCC, Federal Reserve and the FDIC. A substantial portion of Old National's cash revenue is derived from dividends paid to it by Old National Bank. These dividends are subject to various legal and regulatory restrictions as summarized in Note 25 to the consolidated financial statements.

Legislative and Regulatory Initiatives. From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of Old National in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. Old National cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of Old National. A change in statutes, regulations or regulatory policies applicable to Old National or any of its subsidiaries could have a material effect on Old National's business, financial condition and results of operations.

AVAILABLE INFORMATION

All reports filed electronically by Old National with the SEC, including the annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements, other information and amendments to those reports filed or furnished (if applicable), are accessible at no cost on Old National's web site at www.oldnational.com as soon as reasonably practicable after electronically submitting such materials to the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, and Old National's filings are accessible on the SEC's web site at www.sec.gov.

ITEM 1A. RISK FACTORS

There are a number of risks and uncertainties that could adversely affect Old National's business, financial condition, results of operations or cash flows, and access to liquidity. Old National's Enterprise Risk Management program is an enterprise-wide framework for identifying, managing, mitigating, monitoring, aggregating, and reporting risks. The following major risks identified by Old National's Enterprise Risk Management Program are described below: strategic, financial, and reputational; credit; market, interest rate, and liquidity; operational; and legal, regulatory, and compliance.

Strategic, Financial, and Reputational Risks

Economic conditions have affected and could continue to adversely affect our revenues and profits.

Old National's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services that Old National offers, is highly dependent upon the business environment in the markets where Old National operates and in the United States as a whole. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, low unemployment, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment, natural disasters, terrorist acts, or a combination of these or other factors.

An economic downturn or sustained, high unemployment levels, and stock market volatility may negatively impact our operating results and have a negative effect on the ability of our borrowers to make timely repayments of their loans increasing the risk of loan defaults and losses.

Changes in economic or political conditions could adversely affect Old National's earnings, as the ability of Old National's borrowers to repay loans, and the value of the collateral securing such loans, decline.

Old National's success depends, to a certain extent, upon economic or political conditions, local and national, as well as governmental monetary policies. Conditions such as recession, unemployment, changes in interest rates, inflation, money supply, and other factors beyond Old National's control may adversely affect its asset quality, deposit levels, and loan demand and, therefore, Old National's earnings. Because Old National has a significant amount of commercial real estate loans, decreases in real estate values could adversely affect the value of property used as collateral. Adverse changes in the economy may also have a negative effect on the ability of Old National's borrowers to make timely repayments of their loans, which would have an adverse impact on Old National's earnings. In addition, substantially all of Old National's loans are to individuals and businesses in Old National's market area. Consequently, any economic decline in Old National's primary market areas, which include Indiana, Kentucky, Michigan, Wisconsin, and Minnesota could have an adverse impact on Old National's earnings.

Acquisitions may not produce revenue enhancements or cost savings at levels or within timeframes originally anticipated and may result in unforeseen integration difficulties and dilution to existing shareholder value.

We have acquired, and expect to continue to acquire, other financial institutions or parts of those institutions in the future, and we may engage in de novo branch expansion. We may also consider and enter into new lines of business or offer new products or services.

We may incur substantial costs to expand, and we can give no assurance such expansion will result in the levels of profits we seek. There can be no assurance that integration efforts for any mergers or acquisitions will be successful. Also, we may issue equity securities in connection with acquisitions, which could cause ownership and economic dilution to our current shareholders. There is no assurance that, following any mergers or acquisitions, our integration efforts will be successful or that, after giving effect to the acquisition, we will achieve profits comparable to, or better than, our historical experience.

Acquisitions and mergers involve a number of expenses and risks, including:

- the time and costs associated with identifying potential new markets, as well as acquisition and merger targets;
- the accuracy of the estimates and judgments used to evaluate credit, operations, management and market risks with respect to the target institution;
- the time and costs of evaluating new markets, hiring experienced local management and opening new offices, and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- our ability to finance an acquisition and possible dilution to our existing shareholders;
- the diversion of our management’s attention to the negotiation of a transaction, and the integration of the operations and personnel of the combined businesses;
- entry into new markets where we lack experience;
- the introduction of new products and services into our business;
- the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on our results of operations;
- closing delays and increased expenses related to the resolution of lawsuits filed by shareholders of targets; and
- the risk of loss of key employees and customers.

Old National must generally receive federal regulatory approval before it can acquire a bank or bank holding company. Old National cannot be certain when or if, or on what terms and conditions, any required regulatory approvals will be granted. Old National may be required to sell banks or branches as a condition to receiving regulatory approval.

Future acquisitions could be material to Old National and it may issue additional shares of stock to pay for those acquisitions, which would dilute current shareholders’ ownership interests.

Our accounting estimates and risk management processes rely on analytical and forecasting models.

The processes that we use to estimate probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depend upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If our models for determining interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If our models for determining probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If our models to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition, and results of operations.

Old National operates in an extremely competitive market, and Old National's business will suffer if Old National is unable to compete effectively.

In our market area, Old National encounters significant competition from other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds, and other financial intermediaries. In addition, FinTech start-ups are emerging in key areas of banking. Our competitors may have substantially greater resources and lending limits than Old National does and may offer services that Old National does not or cannot provide. Many of our nonfinancial institution competitors have fewer regulatory constraints, broader geographic service areas, and, in some cases, lower cost structures. Old National's profitability depends upon Old National's continued ability to compete successfully in Old National's market area.

Our business could suffer if we fail to attract and retain skilled people.

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities we engage in can be intense. We may not be able to hire the best people or to keep them. The loss of any of our key personnel or an inability to continue to attract, retain, and motivate key personnel could adversely affect our business.

We may not be able to pay dividends in the future in accordance with past practice.

Old National has traditionally paid a quarterly dividend to common stockholders. The payment of dividends is subject to legal and regulatory restrictions. Any payment of dividends in the future will depend, in large part, on Old National's earnings, capital requirements, financial condition, and other factors considered relevant by Old National's Board of Directors.

Old National is an entity separate and distinct from Old National Bank. Old National Bank conducts most of our operations and Old National depends upon dividends from Old National Bank to service its debt and to pay dividends to Old National's shareholders. The availability of dividends from Old National Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition including liquidity and capital adequacy of Old National Bank and other factors, that the OCC could assert that the payment of dividends or other payments is an unsafe or unsound practice. In addition, the payment of dividends by our other subsidiaries is also subject to the laws of the subsidiary's state of incorporation, and regulatory capital and liquidity requirements applicable to such subsidiaries. At December 31, 2018, Old National Bank could pay dividends of $92.9 million without prior regulatory approval. In the event that Old National Bank was unable to pay dividends to us, we in turn would likely have to reduce or stop paying dividends on our Common Stock. Our failure to pay dividends on our Common Stock could have a material adverse effect on the market price of our Common Stock. See "Business – Supervision and Regulation – Dividend Limitations" and Note 25 to the consolidated financial statements.

Old National may not realize the expected benefits of its strategic imperatives.

Old National's ability to compete depends on a number of factors, including among others its ability to develop and successfully execute strategic plans and imperatives. Our strategic priorities include consistent quality earnings, enhanced management discipline, and strong risk management; greater confidence in decision making and appropriate levels of risk taking; fewer operational surprises, disruptions and losses; improved operational effectiveness and efficiency; more effective deployment of resources; and increased awareness and involvement in the achievement of strategic goals. Our inability to execute on or achieve the anticipated outcomes of our strategic priorities may affect how the market perceives us and could impede our growth and profitability.

Credit Risk

If Old National's actual loan losses exceed Old National's allowance for loan losses, Old National's net income will decrease.

Old National makes various assumptions and judgments about the collectibility of Old National's loan portfolio, including the creditworthiness of Old National's borrowers and the value of the real estate and other assets serving as collateral for the repayment of Old National's loans. Despite Old National's underwriting and monitoring practices, the effect of a declining economy could negatively impact the ability of Old National's borrowers to repay loans in a timely manner and could also negatively impact collateral values. As a result, Old National may experience significant loan losses that could have a material adverse effect on Old National's operating results. Since Old National must use assumptions regarding individual loans and the economy, Old National's current allowance for loan losses may not be sufficient to cover actual loan losses. Old National's assumptions may not anticipate the severity or duration of the current credit cycle; and Old National may need to significantly increase Old National's provision for losses on loans if one or more of Old National's larger loans or credit relationships becomes delinquent or if Old National expands its commercial real estate and commercial lending. In addition, federal and state regulators periodically review Old National's allowance for loan losses and may require Old National to increase the provision for loan losses or recognize loan charge-offs. Material additions to Old National's allowance would materially decrease Old National's net income. There can be no assurance that Old National's

monitoring procedures and policies will reduce certain lending risks or that Old National's allowance for loan losses will be adequate to cover actual losses.

Old National's loan portfolio includes loans with a higher risk of loss.

Old National Bank originates commercial real estate loans, commercial loans, agricultural real estate loans, agricultural loans, consumer loans, and residential real estate loans primarily within Old National's market areas. Commercial real estate, commercial, consumer, and agricultural real estate and operating loans may expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. These loans also have greater credit risk than residential real estate for the following reasons:

- *Commercial Real Estate Loans.* Repayment is dependent upon income being generated in amounts sufficient to cover operating expenses and debt service.
- *Commercial Loans.* Repayment is dependent upon the successful operation of the borrower's business.
- *Consumer Loans.* Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss.
- *Agricultural Loans.* Repayment is dependent upon the successful operation of the business, which is greatly dependent on many things outside the control of either Old National Bank or the borrowers. These factors include weather, input costs, commodity and land prices, and interest rates.

If Old National forecloses on collateral property, Old National may be subject to the increased costs associated with the ownership of real property, resulting in reduced revenues.

Old National may have to foreclose on collateral property to protect Old National's investment and may thereafter own and operate such property, in which case Old National will be exposed to the risks inherent in the ownership of real estate. The amount that Old National, as a mortgagee, may realize after a default is dependent upon factors outside of Old National's control, including, but not limited to: (i) general or local economic conditions; (ii) neighborhood values; (iii) interest rates; (iv) real estate tax rates; (v) operating expenses of the mortgaged properties; (vi) environmental remediation liabilities; (vii) ability to obtain and maintain adequate occupancy of the properties; (viii) zoning laws; (ix) governmental rules, regulations and fiscal policies; and (x) acts of God. Certain expenditures associated with the ownership of real estate, principally real estate taxes, insurance, and maintenance costs, may adversely affect the income from the real estate. Therefore, the cost of operating real property may exceed the income earned from such property, and Old National may have to advance funds in order to protect Old National's investment, or Old National may be required to dispose of the real property at a loss. The foregoing expenditures and costs could adversely affect Old National's ability to generate revenues, resulting in reduced levels of profitability.

The soundness of other financial institutions could adversely affect Old National.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. Old National has exposure to many different industries and counterparties, and Old National and certain of its subsidiaries routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutions. Many of these transactions expose Old National to credit risk in the event of default of its counterparty. In addition, Old National's credit risk may be affected when collateral is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure. These types of losses could materially adversely affect Old National's results of operations or financial condition.

Market, Interest Rate, and Liquidity Risks

The price of Old National's Common Stock may be volatile, which may result in losses for investors.

General market price declines or market volatility in the future could adversely affect the price of Old National's Common Stock. In addition, the following factors may cause the market price for shares of Old National's Common Stock to fluctuate:

- announcements of developments related to Old National's business;
- fluctuations in Old National's results of operations;
- sales or purchases of substantial amounts of Old National's securities in the marketplace;
- general conditions in Old National's banking niche or the worldwide economy;
- a shortfall or excess in revenues or earnings compared to securities analysts' expectations;
- changes in analysts' recommendations or projections; and
- Old National's announcement of new acquisitions or other projects.

Changes in interest rates could adversely affect Old National's results of operations and financial condition.

Old National's earnings depend substantially on Old National's interest rate spread, which is the difference between (i) the rates Old National earns on loans, securities and other earning assets and (ii) the interest rates Old National pays on deposits and other borrowings. These rates are highly sensitive to many factors beyond Old National's control, including general economic conditions and the policies of various governmental and regulatory authorities. If market interest rates rise, Old National will have competitive pressures to increase the rates that Old National pays on deposits, which could result in a decrease of Old National's net interest income. If market interest rates decline, Old National could experience fixed-rate loan prepayments and higher investment portfolio cash flows, resulting in a lower yield on earning assets. Old National's earnings can also be impacted by the spread between short-term and long-term market interest rates. If short-term and long-term market interest rates converge, Old National's interest rate spread could decline and result in a decrease of Old National's net interest income.

Our wholesale funding sources may prove insufficient to replace deposits or support our future growth.

As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. These sources include brokered certificates of deposit, repurchase agreements, and federal funds purchased. Negative operating results or changes in industry conditions could lead to an inability to replace these additional funding sources at maturity. Our financial flexibility could be constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at

acceptable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our results of operations and financial condition would be negatively affected.

A reduction in our credit rating could adversely affect our business and/or the holders of our securities.

The credit rating agencies rating our indebtedness regularly evaluate Old National and Old National Bank, and credit ratings are based on a number of factors, including our financial strength and ability to generate earnings, as well as factors not entirely within our control, including conditions affecting the financial services industry and the economy and changes in rating methodologies. There can be no assurance that we will maintain our current credit ratings. A downgrade of the credit ratings of Old National or Old National Bank could adversely affect our access to liquidity and capital, and could significantly increase our cost of funds, and decrease the number of investors and counterparties willing to lend to us or purchase our securities. This could affect our growth, profitability, and financial condition, including liquidity.

Operational Risks

A failure or breach, including cyber-attacks, of our operational or security systems, could disrupt our business, result in the disclosure of confidential information, damage our reputation, and create significant financial and legal exposure.

Although we devote significant resources to maintain and regularly upgrade our systems and processes that are designed to protect the security of our computer systems, software, networks, and other technology assets and the confidentiality, integrity, and availability of information belonging to us and our customers, there is no assurance that our security measures will provide absolute security. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. In fact, many other financial services institutions and companies engaged in data processing have reported breaches in the security of their websites or other systems, some of which have involved sophisticated and targeted attacks intended to obtain unauthorized access to confidential information, destroy data, disable or degrade service, or sabotage systems, often through the introduction of computer viruses or malware, cyberattacks, and other means. Certain financial institutions in the United States have also experienced attacks from technically sophisticated and well-resourced third parties that were intended to disrupt normal business activities by making internet banking systems inaccessible to customers for extended periods. These “denial-of-service” attacks have not breached our data security systems, but require substantial resources to defend, and may affect customer satisfaction and behavior.

Despite our efforts to ensure the integrity of our systems, it is possible that we may not be able to anticipate or to implement effective preventive measures against all security breaches of these types, especially because the techniques used change frequently or are not recognized until launched, and because security attacks can originate from a wide variety of sources, including persons who are involved with organized crime or associated with external service providers or who may be linked to terrorist organizations or hostile foreign governments. Those parties may also attempt to fraudulently induce employees, customers or other users of our systems to disclose sensitive information in order to gain access to our data or that of our customers or clients. We have implemented employee and customer awareness training around phishing, malware, and other cyber risks. These risks may increase in the future as we continue to increase our mobile payments and other internet-based product offerings and expand our internal usage of web-based products and applications.

If our security systems were penetrated or circumvented, it could cause serious negative consequences for us, including significant disruption of our operations, misappropriation of our confidential information or that of our customers, or damage our computers or systems and those of our customers and counterparties, and could result in violations of applicable privacy and other laws, financial loss to us or to our customers, loss of confidence in our security measures, customer dissatisfaction, significant litigation exposure, and harm to our reputation, all of which could have a material adverse effect on us.

We rely on third party vendors, which could expose Old National to additional cybersecurity risks.

Third party vendors provide key components of our business infrastructure, including certain data processing and information services. On our behalf, third parties may transmit confidential, propriety information. Although we require third party providers to maintain certain levels of information security, such providers may remain vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious attacks that could ultimately compromise sensitive information. While we may contractually limit our liability in connection with attacks against third party providers, Old National remains exposed to the risk of loss associated with such vendors. In addition, a number of our vendors are large national entities with dominant market presence in their respective fields. Their services could prove difficult to replace in a timely manner if a failure or other service interruption were to occur. Failures of certain vendors to provide contracted services could adversely affect our ability to deliver products and services to our customers and cause us to incur significant expense.

Failure to keep pace with technological change could adversely affect Old National's results of operations and financial condition.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Old National's future success depends, in part,

upon its ability to address customer needs by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in Old National's operations. Old National may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could negatively affect Old National's growth, revenue, and profit.

Changes in consumer use of banks and changes in consumer spending and savings habits could adversely affect Old National's financial results.

Technology and other changes now allow many customers to complete financial transactions without using banks. For example, consumers can pay bills and transfer funds directly without going through a bank. This process of eliminating banks as intermediaries could result in the loss of fee income, as well as the loss of customer deposits and income generated from those deposits. In addition, changes in consumer spending and savings habits could adversely affect Old National's operations, and Old National may be unable to timely develop competitive new products and services in response to these changes.

Old National's controls and procedures may fail or be circumvented, and Old National's methods of reducing risk exposure may not be effective.

Old National regularly reviews and updates its internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Old National also maintains an Enterprise Risk Management program designed to identify, manage, mitigate, monitor, aggregate, and report risks. Any system of controls and any system to reduce risk exposure, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Additionally, instruments, systems, and strategies used to hedge or otherwise manage exposure to various types of market compliance, credit, liquidity, operational, and business risks and enterprise-wide risk could be less effective than anticipated. As a result, Old National may not be able to effectively mitigate its risk exposures in particular market environments or against particular types of risk.

Legal, Regulatory, and Compliance Risks

We have risk related to legal proceedings.

We are involved in judicial, regulatory, and arbitration proceedings concerning matters arising from our business activities and fiduciary responsibilities. We establish reserves for legal claims when payments associated with the

claims become probable and the costs can be reasonably estimated. We may still incur legal costs for a matter even if we have not established a reserve. In addition, the actual cost of resolving a legal claim may be substantially higher than any amounts reserved for that matter. The ultimate resolution of a pending or future legal proceeding, depending on the remedy sought and granted, could materially adversely affect our results of operations and financial condition.

Old National operates in a highly regulated environment, and changes in laws and regulations to which Old National is subject may adversely affect Old National's results of operations.

Old National operates in a highly regulated environment and is subject to extensive regulation, supervision, and examination by, among others, the OCC, the FDIC, the CFPB, the Federal Reserve, and the State of Indiana. Such regulation and supervision of the activities in which an institution may engage is primarily intended for the protection of the depositors and federal deposit insurance funds. In addition, the Treasury has certain supervisory and oversight duties and responsibilities under EESA and the CPP. See "Business – Supervision and Regulation" herein. Applicable laws and regulations may change, and such changes may adversely affect Old National's business. The Dodd-Frank Act, enacted in July 2010, mandated the most wide-ranging overhaul of financial industry regulation in decades. This legislation, among other things, weakened federal preemption of state consumer protection laws and established the CFPB with broad authority to administer and enforce a new federal regulatory framework of consumer financial regulation, including consumer mortgage banking. The scope and impact of many of the Dodd-Frank Act provisions were determined and issued over time. The impact of the Dodd-Frank Act on Old National has been substantial. Provisions in the legislation that affect the payment of interest on demand deposits and collection of interchange fees increased the costs associated with certain deposits and placed

limitations on certain revenues those deposits generate. In addition, the Dodd-Frank Act required Old National to change certain of its business practices, intensified the regulatory supervision of Old National and the financial services industry, increased Old National's capital requirements, and imposed additional assessments and costs on Old National. Requirements to maintain higher levels of capital or liquidity to address potential adverse stress scenarios could adversely impact the Company's net income.

Regulatory authorities also have extensive discretion in connection with their supervisory and enforcement activities, including but not limited to the imposition of restrictions on the operation of an institution, the classification of assets by the institution, the adequacy of an institution's Bank Secrecy Act/Anti Money Laundering program management, and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of restrictions on activities, regulatory policy, regulations, or legislation, including but not limited to changes in the regulations governing institutions, could have a material impact on Old National and its operations.

Changes in accounting policies, standards, and interpretations could materially affect how Old National reports its financial condition and results of operations.

The FASB periodically changes the financial accounting and reporting standards governing the preparation of Old National's financial statements. Additionally, those bodies that establish and/or interpret the financial accounting and reporting standards (such as the FASB, SEC, and banking regulators) may change prior interpretations on how these standards should be applied. These changes can be difficult to predict and can materially affect how Old National records and reports its financial condition and results of operations. In some cases, Old National could be required to retroactively apply a new or revised standard, resulting in changes to previously reported financial results.

If Old National fails to meet regulatory capital requirements which may require heightened capital, we may be forced to raise capital or sell assets.

Old National is subject to regulations that require us to satisfy certain capital ratios, such as the ratio of our Tier 1 capital to our risk-based assets. Both the Dodd-Frank Act, which reformed the regulation of financial institutions in a comprehensive manner, and the Basel III regulatory capital reforms, which increase both the amount and quality of capital that financial institutions must hold, will impact our capital requirements. Specifically, in July 2013, the U.S. federal banking authorities approved the implementation of the Basel III Capital Rules. The Basel III Capital Rules are applicable to all U.S. banks that are subject to minimum capital requirements as well as to bank and saving and loan holding companies, other than "small bank holding companies" (generally bank holding companies with consolidated assets of less than $500 million). The Basel III Capital Rules not only increase most of the required minimum regulatory capital ratios, they introduce a new Common Equity Tier 1 Capital ratio and the concept of a capital conservation buffer. The Basel III Capital Rules also expand the current definition of capital by establishing additional criteria that capital instruments must meet to be considered Additional Tier 1 Capital (i.e., Tier 1 Capital in addition to Common Equity) and Tier 2 Capital. A number of instruments that now generally qualify as Tier 1 Capital will not qualify or their qualifications will change when the Basel III Capital Rules are fully implemented. The Basel

III Capital Rules have maintained the general structure of the current prompt corrective action thresholds while incorporating the increased requirements, including the Common Equity Tier 1 Capital ratio. In order to be a "well-capitalized" depository institution under the new regime, an institution must maintain a Common Equity Tier 1 Capital ratio of 6.5% or more, a Tier 1 Capital ratio of 8% or more, a Total Capital ratio of 10% or more, and a leverage ratio of 5% or more. Institutions must also maintain a capital conservation buffer consisting of Common Equity Tier 1 Capital. Financial institutions became subject to the Basel III Capital Rules on January 1, 2015 with a phase-in period through 2019 for many of the changes. If we are unable to satisfy these heightened regulatory capital requirements, due to a decline in the value of our loan portfolio or otherwise, we will be required to improve such capital ratios by either raising additional capital or by disposing of assets. If we choose to dispose of assets, we cannot be certain that we will be able to do so at prices that we believe to be appropriate, and our future operating results could be negatively affected. If we choose to raise additional capital, we may accomplish this by selling additional shares of Common Stock, or securities convertible into or exchangeable for Common Stock, which could significantly dilute the ownership percentage of holders of our Common Stock and cause the market price of our Common Stock to decline. Additionally, events or circumstances in the capital markets generally may increase our capital costs and impair our ability to raise capital at any given time.

Our earnings could be adversely impacted by incidences of fraud and compliance failure.

Financial institutions are inherently exposed to fraud risk. A fraud can be perpetrated by a customer of Old National, an employee, a vendor, or members of the general public. We are most subject to fraud and compliance risk in connection with the origination of loans, ACH transactions, wire transactions, ATM transactions, and checking transactions. Our largest fraud risk, associated with the origination of loans, includes the intentional misstatement of information in property appraisals or other underwriting documentation provided to us by third parties. Compliance risk is the risk that loans are not originated in compliance with applicable laws and regulations and our standards. There can be no assurance that we can prevent or detect acts of fraud or violation of law or our compliance standards by the third parties that we deal with. Repeated incidences of fraud or compliance failures would adversely impact the performance of our loan portfolio.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2018, Old National and its affiliates operated a total of 191 banking centers, primarily in the states of Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. Of these facilities, 118 were owned. We lease 73 banking centers from unaffiliated third parties. The terms of these leases range from one years and five months to twenty-five years. See Note 7 to the consolidated financial statements.

Impacting the number of Old National's banking centers in 2018 was the acquisition of Klein (18 banking centers), the sale of 10 banking centers in Wisconsin to Marine Credit Union of La Crosse, Wisconsin, and the consolidation of 10 banking centers throughout the franchise.

Old National also has several administrative offices located throughout its footprint, including the executive offices of Old National which are located at 1 Main Street, Evansville, Indiana. This building, which was previously leased, was purchased in 2016.

ITEM 3. LEGAL PROCEEDINGS

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

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

period. Old National will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated.

Old National is not currently involved in any material litigation.

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Old National's Common Stock is traded on the NASDAQ under the ticker symbol ONB. There were 34,536 shareholders of record as of December 31, 2018.

The following table summarizes the purchases of equity securities made by Old National during the fourth quarter of 2018:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
10/01/18 - 10/31/18	—	$ —	—	—
11/01/18 - 11/30/18	1,294	18.16	—	—
12/01/18 - 12/31/18	295	15.94	—	—
Total	1,589	$ 17.75	—	—

The Board of Directors did not authorize a stock repurchase plan for 2018. During the year ended December 31, 2018, Old National repurchased a limited number of shares associated with employee share-based incentive programs.

On January 24, 2019, the Board of Directors declared a quarterly cash dividend of $0.13 per common share.

EQUITY COMPENSATION PLAN INFORMATION

The following table contains information concerning the Amended and Restated 2008 Incentive Compensation Plan approved by security holders, as of December 31, 2018.

	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted-average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))

Plan Category	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,404,238	$ 13.88	4,398,631
Equity compensation plans not approved by security holders	—	—	—
Total	1,404,238	$ 13.88	4,398,631

At December 31, 2018, 4.4 million shares remain available for issuance under the Amended and Restated 2008 Incentive Compensation Plan.

The following table compares cumulative five-year total shareholder returns, assuming reinvestment of dividends, for our common stock to cumulative total returns of a broad-based equity market index and two published industry indices. The comparison of shareholder returns (change in December year end stock price plus reinvested dividends) for each of the periods assumes that $100 was invested on December 31, 2013, in common stock of each of the Company, the S&P Small Cap 600 Index, the NYSE Financial Index and the SNL Bank and Thrift Index with investment weighted on the basis of market capitalization.

ITEM 6. SELECTED FINANCIAL DATA

(dollars in thousands, except per share data)	2018	2017	2016	2015	2014
Operating Results					
Net interest income	$537,602	$437,168	$402,703	$366,116	$366,370
Conversion to fully taxable equivalent (1)	11,394	23,091	21,293	19,543	16,999
Net interest income - tax equivalent basis	548,996	460,259	423,996	385,659	383,369
Provision for loan losses	6,966	3,050	960	2,923	3,097
Noninterest income	195,305	183,382	252,830	230,632	165,129
Noninterest expense	517,261	448,836	454,147	430,932	386,438
Net income	190,830	95,725	134,264	116,716	103,667
Common Share Data (2)					
Weighted average diluted shares	156,539	138,513	128,301	116,255	108,365
Net income (diluted)	$1.22	$0.69	$1.05	$1.00	$0.95
Cash dividends	0.52	0.52	0.52	0.48	0.44
Common dividend payout ratio (3)	42 %	75 %	50 %	48 %	46 %
Book value at year-end	15.36	$14.17	$13.42	$13.05	$12.54
Stock price at year-end	15.40	17.45	18.15	13.56	14.88
Balance Sheet Data (at December 31)					
Loans (4)	$12,258,803	$11,136,051	$9,101,194	$6,962,215	$6,531,691
Total assets	19,728,435	17,518,292	14,860,237	11,991,527	11,646,051
Deposits	14,349,949	12,605,764	10,743,253	8,400,860	8,490,664
Borrowings	2,493,793	2,578,204	2,152,086	1,920,246	1,469,911
Shareholders' equity	2,689,570	2,154,397	1,814,417	1,491,170	1,465,764
Performance Ratios					
Return on average assets	1.07 %	0.63 %	0.98 %	0.98 %	0.99 %
Return on average common shareholders' equity	8.42	4.98	7.84	7.88	7.91
Net interest margin (5)	3.54	3.48	3.58	3.72	4.22
Efficiency ratio (5)	67.74	68.87	65.82	68.65	70.03
Asset Quality (6)					
Net charge-offs (recoveries) to average loans	0.02 %	0.03 %	0.04 %	(0.02)%	0.04 %
Allowance for loan losses to ending loans	0.45	0.45	0.55	0.75	0.76
Allowance for loan losses	$55,461	$50,381	$49,808	$52,233	$47,849
Underperforming assets (7)	179,425	154,220	164,657	160,072	170,535
Allowance for loan losses to nonaccrual loans (8)	35.22 %	40.33 %	37.90 %	39.46 %	33.97 %
Other Data					

Full-time equivalent employees	2,892	2,801	2,733	2,652	2,938
Banking centers	191	191	203	160	195

(1) Calculated using the federal statutory tax rate in effect of 21% for 2018 and 35% for 2014 - 2017.

(2) Diluted data assumes the exercise of stock options and the vesting of restricted stock.

(3) Cash dividends per share divided by net income per share (basic).

(4) Includes loans held for sale.

(5) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section of Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" for reconciliations to GAAP financial measures.

(6) Excludes loans held for sale.

(7) Includes nonaccrual loans, renegotiated loans, loans 90 days past due still accruing, and other real estate owned. Includes $12.4 million and $24.4 million of covered assets in 2015 and 2014, respectively, acquired in an FDIC assisted transaction, which were covered by loss sharing agreements with the FDIC providing for specified loss protection. On June 22, 2016, Old National entered into an early termination agreement with the FDIC that terminated all loss share agreements.

(8) Includes approximately $20.5 million, $12.6 million, $16.7 million, $15.9 million, and $41.2 million for 2018, 2017, 2016, 2015, and 2014, respectively, of purchased credit impaired loans that are categorized as nonaccrual because the collection of principal or interest is doubtful. These loans are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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The following discussion is an analysis of our results of operations for the fiscal years ended December 31, 2018, 2017, and 2016, and financial condition as of December 31, 2018 and 2017. This discussion and analysis should be read in conjunction with our consolidated financial statements and related notes. This discussion contains forward-looking statements concerning our business. Readers are cautioned that, by their nature, forward-looking statements are based on estimates and assumptions and are subject to risks, uncertainties, and other factors. Actual results may differ materially from our expectations that are expressed or implied by any forward-looking statement. The discussion in Item 1A, "Risk Factors," lists some of the factors that could cause our actual results to vary materially from those expressed or implied by any forward-looking statements, and such discussion is incorporated into this discussion by reference.

GENERAL OVERVIEW

Old National is the largest financial holding company incorporated in the state of Indiana and maintains its principal executive offices in Evansville, Indiana. Old National, through Old National Bank, provides a wide range of services, including commercial and consumer loan and depository services, and other traditional banking services. Old National also provides services to supplement the traditional banking business including fiduciary and wealth management services, investment and brokerage services, investment consulting, and other financial services.

Our basic mission is to be THE community bank in the cities and towns we serve. We focus on establishing and maintaining long-term relationships with customers, and are committed to serving the financial needs of the communities in our market area. Old National provides financial services primarily in Indiana, Kentucky, Michigan, Wisconsin, and Minnesota.

CORPORATE DEVELOPMENTS IN FISCAL 2018

In 2018, we increased our presence in Minnesota through our acquisition of Klein. The acquisition provides us not only additional opportunities in the large and rapidly growing Minneapolis-St. Paul market, but also enables greater scale economics across our entire five-state footprint. Other highlights experienced in 2018 include:

- highest loan production year in our history with a strong pipeline that continues to build;
- organic commercial and commercial real estate loan growth of 4% (including loans held for sale) in addition to $1.049 billion of loans from the Klein partnership;
- cost of total deposits remained well controlled, with an increase of only 13 basis points to 0.32% and a deposit beta of 14.7%;
- strong credit quality metrics including charge-offs to average loans of 0.02%; and
- continued rationalization of our banking center network, resulting in the sale of 10 branches at a gain of $14.0 million.

During 2018, our net interest income increased substantially to $537.6 million compared to $437.2 million in 2017, an increase of 23%. Noninterest income grew from $183.4 million in 2017 to $195.3 million in 2018 primarily due to the gain on branch sales. We benefited from higher noninterest income attributable to a full year of Anchor (MN) results in 2018 and the two months of Klein contribution as compared to 2017, which only reflected two months of the Anchor (MN) operations. Offsetting some of the benefit of the Anchor (MN) and Klein results was a decline in gains from sales of investment securities. Our noninterest expenses increased from $448.8 million in 2017 to $517.3 million in 2018 reflecting acquisition related expenses and divestiture costs. Net income for 2018 was $190.8 million compared to $95.7 million in 2017. Diluted earnings per share were $1.22 per share in 2018, compared to $0.69 per

share in 2017. As did other banks and U.S. corporations, our 2018 results benefited from the reduction in the federal corporate tax rate to 21%, which became effective on January 1, 2018. Net income in 2017 reflected a 35% federal tax rate and also included a one-time $39.3 million tax expense recorded in December 2017 for the revaluation of our deferred income tax asset.

BUSINESS OUTLOOK

The U.S. economy grew by approximately 3% in 2018 as measured by the change in GDP. The strong economic growth was aided by the federal tax cuts and other fiscal measures. Other measures of economic health include the near record low unemployment level of 3.7% despite an increase in the labor force participation rate, increases in personal income of 2.7% year-over-year, increases in home prices, lower household debt burdens, well-controlled inflation, and interest rates that remain low relative to historical levels. It is anticipated that the economy will

continue to achieve healthy growth in 2019 as a result of the stimulus effect of the tax reductions but probably not as robust as experienced in 2018. There are ongoing threats to economic expansion in 2019 and beyond, including the potential impact of the trade dispute with China, a slowdown in new home construction, and the increasing federal and household debt burdens.

We will continue to focus on our core strategic principles of basic banking in 2019, which are loan growth, fee-based income, and expense management.

Organic loan growth is a priority and we expect our strong loan production to continue. We will continue to adhere to our risk profile and disciplined underwriting standards. We have not experienced any specific sector credit related weaknesses, yet we remain particularly diligent in various commercial real estate subsectors such as senior housing, retail, and multifamily.

Our fee-based businesses continue to build up their product sets in all of our markets. We have made investments in these businesses and believe they are well positioned for growth in 2019.

At the same time, we will continue to enhance our technology and operational efficiency to improve the client experience. Since 2010, we have consolidated or closed 201 branches and increased our average branch size from approximately $34 million to $75 million in deposits. We will continue to evaluate our franchise for additional consolidation opportunities in 2019.

As we continue our measured growth strategy, our view toward additional partnerships has not changed in this more challenging environment. We remain an active looker in our target markets and a highly selective, disciplined buyer. We continue to believe in our ability to bring a larger balance sheet with better capital and an enhanced product set to a partner that will allow them to better serve their clients.

On May 2, 2019, Bob Jones will retire as CEO and will continue to serve as the Company’s Chairman of the Board through January 2020. Our corporate board of directors has appointed Jim Ryan, currently Old National’s CFO, to succeed Mr. Jones as CEO and has elected Brendon Falconer to succeed Mr. Ryan as the Company’s CFO. Mr. Jones’ tenure has further strengthened the bank’s culture of transparency, ethics, and character. We believe this succession will continue these attributes that define our bank’s culture.

As we look ahead to 2019, we believe our increased scale will allow us to continue our focus on increasing positive operating leverage.

FINANCIAL HIGHLIGHTS

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

	Three Months Ended			Years Ended	
(dollars and shares in thousands, except per share data)	December 31, 2018	September 30, 2018	December 31, 2017	December 31, 2018	2017
Income Statement:					
Net interest income	$146,225	$130,842	$118,556	$537,602	$437,168
Taxable equivalent adjustment (1)	3,049	2,753	6,139	11,394	23,091
Provision for loan losses	3,390	750	1,037	6,966	3,050
Noninterest income	58,154	45,957	44,825	195,305	183,382
Noninterest expense	150,268	119,376	140,432	517,261	448,836
Net income (loss)	47,498	51,348	(18,493)	190,830	95,725
Common Share Data:					
Weighted average diluted shares	167,992	152,784	146,875	156,539	138,513
Net income (loss) (diluted)	$0.28	$0.34	$(0.13)	$1.22	$0.69
Cash dividends	0.13	0.13	0.13	$0.52	$0.52
Common dividend payout ratio (2)	46 %	38 %	N/M %	42 %	75 %
Book value	$15.36	$14.58	$14.17	$15.36	$14.17
Stock price	15.40	19.30	17.45	15.40	17.45
Tangible common book value (3)	9.00	8.86	8.37	9.00	8.37
Performance Ratios:					
Return on average assets	1.01 %	1.18 %	(0.45)%	1.07 %	0.63 %
Return on average common equity	7.59	9.28	(3.51)	8.42	4.98
Return on tangible common equity (3)	12.88	15.99	(5.12)	12.83	8.12
Return on average tangible common equity (3)	13.84	16.10	(5.05)	14.97	8.59
Net interest margin (3)	3.64	3.51	3.47	3.54	3.48
Efficiency ratio (3)	70.33	64.71	81.60	67.74	68.87
Net charge-offs (recoveries) to average loans	0.02	0.06	0.03	0.02	0.03
Allowance for loan losses to ending loans	0.45	0.47	0.45	0.45	0.45
Non-performing loans to ending loans	1.43	1.47	1.30	1.43	1.30
Balance Sheet:					
Total loans	$12,243,892	$11,292,659	$11,118,121	$12,243,892	$11,118,121
Total assets	19,728,435	17,567,759	$17,518,292	19,728,435	17,518,292
Total deposits	14,349,949	12,598,200	12,605,764	14,349,949	12,605,764
Total borrowed funds	2,493,793	2,576,039	2,578,204	2,493,793	2,578,204
Total shareholders' equity	2,689,570	2,220,680	2,154,397	2,689,570	2,154,397
Nonfinancial Data:					

Full-time equivalent employees	2,892	2,554	2,801	2,892	2,801
Banking centers	191	182	191	191	191

(1) Calculated using the federal statutory tax rate in effect of 21% for the 2018 periods and 35% for the 2017 periods.

(2) Cash dividends per share divided by net income per share (basic).

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

NON-GAAP FINANCIAL MEASURES

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

The following table presents GAAP to non-GAAP reconciliations.

(dollars and shares in thousands, except per share data)	Three Months Ended December 31, 2018	2017	Years Ended December 31, 2018	2017
Tangible common book value:				
Shareholders' equity (GAAP)	$2,689,570	$2,154,397	$2,689,570	$2,154,397
Deduct: Goodwill	1,036,258	828,051	1,036,258	828,051
Intangible assets	77,016	53,096	77,016	53,096
Tangible shareholders' equity (non-GAAP)	$1,576,296	$1,273,250	$1,576,296	$1,273,250
Period end common shares	175,141	152,040	175,141	152,040
Tangible common book value	9.00	8.37	9.00	8.37
Return on tangible common equity:				
Net income (loss) (GAAP)	$47,498	$(18,493)	$190,830	$95,725
Add: Intangible amortization (net of tax)	3,266	2,210	11,410	7,697
Tangible net income (loss) (non-GAAP)	$50,764	$(16,283)	$202,240	$103,422
Tangible shareholders' equity (non-GAAP) (see above)	$1,576,296	$1,273,250	$1,576,296	$1,273,250
Return on tangible common equity	12.88 %	(5.12)%	12.83 %	8.12 %
Return on average tangible common equity:				
Tangible net income (loss) (non-GAAP) (see above)	$50,764	$(16,283)	$202,240	$103,422
Average shareholders' equity (GAAP)	$2,503,835	$2,104,646	$2,267,327	$1,923,645
Deduct: Average goodwill	969,403	776,862	864,079	685,729
Average intangible assets	66,927	37,802	52,209	34,392
Average tangible shareholders' equity (non-GAAP)	$1,467,505	$1,289,982	$1,351,039	$1,203,524
Return on average tangible common equity	13.84 %	(5.05)%	14.97 %	8.59 %
Net interest margin:				
Net interest income (GAAP)	$146,225	$118,556	$537,602	$437,168
Taxable equivalent adjustment	3,049	6,139	11,394	23,091

Net interest income - taxable equivalent basis				
(non-GAAP)	$149,274	$124,695	$548,996	$460,259
Average earning assets	$16,398,288	$14,389,502	$15,501,053	$13,237,906
Net interest margin	3.64 %	3.47 %	3.54 %	3.48 %
Efficiency ratio:				
Noninterest expense (GAAP)	$150,268	$140,432	$517,261	$448,836
Deduct: Intangible amortization expense	4,134	3,399	14,442	11,841
Adjusted noninterest expense (non-GAAP)	$146,134	$137,033	$502,819	$436,995
Net interest income - taxable equivalent basis				
(non-GAAP) (see above)	$149,274	$124,695	$548,996	$460,259
Noninterest income	58,154	44,825	195,305	183,382
Deduct: Net securities gains (losses)	(357)	1,588	2,060	9,135
Adjusted total revenue (non-GAAP)	$207,785	$167,932	$742,241	$634,506
Efficiency ratio	70.33 %	81.60 %	67.74 %	68.87 %

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

RESULTS OF OPERATIONS

The following table sets forth certain income statement information of Old National for the years ended December 31, 2018, 2017, and 2016:

	Years Ended December 31,		
(dollars in thousands)	2018	2017	2016
Income Statement Summary:			
Net interest income	$537,602	$437,168	$402,703
Provision for loan losses	6,966	3,050	960
Noninterest income	195,305	183,382	252,830
Noninterest expense	517,261	448,836	454,147
Other Data:			
Return on average common equity	8.42 %	4.98 %	7.84 %
Return on tangible common equity (1)	12.83 %	8.12 %	12.69 %
Return on average tangible common equity (1)	14.97 %	8.59 %	13.73 %
Efficiency ratio (1)	67.74 %	68.87 %	65.82 %
Tier 1 leverage ratio	9.17 %	8.28 %	8.43 %
Net charge-offs (recoveries) to average loans	0.02 %	0.03 %	0.04 %

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

Comparison of Fiscal Years 2018 and 2017

Net Interest Income

Net interest income is the most significant component of our earnings, comprising 73% of 2018 revenues. Net interest income and margin are influenced by many factors, primarily the volume and mix of earning assets, funding sources, and interest rate fluctuations. Other factors include the level of accretion income on purchased loans, prepayment risk on mortgage and investment-related assets, and the composition and maturity of earning assets and interest-bearing liabilities.

Short-term interest rates increased 100 basis points in 2018 as the Federal Reserve increased the discount rate 25 basis points at their March, June, September, and December meetings. The rate increases were driven by the Federal Reserve's inflation and wage pressure expectations in conjunction with an expanding economy. The Treasury yield curve flattened as short-term rates rose while long-term interest rates remained flat. Collectively, these factors marginally improved the outlook for our net interest income and margin.

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

Net interest income is the excess of interest received from earning assets over interest paid on interest-bearing liabilities. For analytical purposes, net interest income is also presented in the table that follows, adjusted to a taxable equivalent basis to reflect what our tax-exempt assets would need to yield in order to achieve the same after-tax yield as a taxable asset. We used the federal statutory tax rate in effect of 21% for 2018 and 35% for 2017 and 2016. This analysis portrays the income tax benefits associated in tax-exempt assets and helps to facilitate a comparison between taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully taxable equivalent basis. Therefore, management believes these measures provide useful information for both management and investors by allowing them to make peer comparisons.

	Years Ended December 31,		
(dollars in thousands)	2018	2017	2016
Net interest income	$537,602	$437,168	$402,703
Conversion to fully taxable equivalent	11,394	23,091	21,293
Net interest income - taxable equivalent basis	$548,996	$460,259	$423,996
Average earning assets	$15,501,053	$13,237,906	$11,840,967
Net interest margin	3.47 %	3.30 %	3.40 %
Net interest margin - taxable equivalent basis	3.54 %	3.48 %	3.58 %

Net interest income was $537.6 million in 2018, a $100.4 million increase from $437.2 million in 2017. Taxable equivalent net interest income was $549.0 million in 2018, a 19% increase from $460.3 million in 2017. The net interest margin on a fully taxable equivalent basis was 3.54% in 2018, a 6 basis point increase compared to 3.48% in 2017. The increase in net interest income in 2018 when compared to 2017 was primarily due to higher average earning assets of $2.263 billion in 2018. Partially offsetting higher average earning assets were higher average interest-bearing liabilities of $1.585 billion. In addition, interest income in 2018 included lower fully taxable equivalent interest income resulting from the income tax rate decrease to 21% in 2018. Net interest income in both 2018 and 2017 included accretion income (interest income in excess of contractual interest income) associated with acquired loans. Accretion income totaled $41.1 million in 2018, compared to $40.8 million in 2017. We expect accretion income to decrease over time, but this may be offset by future acquisitions.

The following table presents a three-year average balance sheet and for each major asset and liability category, its related interest income and yield, or its expense and rate for the years ended December 31.

(tax equivalent basis, dollars in thousands)	2018 Average Balance	2018 Income/ Expense	2018 Yield/ Rate	2017 Average Balance	2017 Income/ Expense	2017 Yield/ Rate	2016 Average Balance	2016 Income/ Expense	2016 Yield/ Rate
Earning Assets									
Money market and other interest-earning investments (1)	$48,240	$630	1.31 %	$35,584	$258	0.72 %	$32,697	$130	0.40 %
Investment securities: (2)									
Treasury and government-sponsored agencies (3)	2,380,817	55,926	2.35	2,085,317	42,235	2.03	1,968,408	37,381	1.90
States and political subdivisions (4)	1,153,315	42,326	3.67	1,134,532	53,359	4.70	1,125,713	53,003	4.71
Other securities	490,464	15,633	3.19	450,127	11,863	2.64	438,832	10,391	2.37
Total investment securities	4,024,596	113,885	2.83	3,669,976	107,457	2.93	3,532,953	100,775	2.85
Loans (including loans held for sale): (5)									
Commercial (4)	2,924,878	131,471	4.49	2,083,779	85,747	4.11	1,835,317	70,591	3.85
Commercial real estate	4,536,897	235,876	5.20	3,426,757	171,483	5.00	2,648,911	150,592	5.69
Residential real estate	2,195,078	89,888	4.09	2,146,279	85,340	3.98	1,995,060	80,963	4.06
Consumer	1,771,364	71,689	4.05	1,875,531	68,142	3.63	1,796,029	65,376	3.64
Total loans	11,428,217	528,924	4.63	9,532,346	410,712	4.31	8,275,317	367,522	4.44
Total earning assets	15,501,053	$643,439	4.15 %	13,237,906	$518,427	3.92 %	11,840,967	$468,427	3.96 %
Less: Allowance for loan losses	(52,316)			(50,845)			(52,215)		
Non-Earning Assets									
Cash and due from banks	210,716			207,677			192,401		
Other assets	2,130,588			1,907,963			1,661,200		
Total assets	$17,790,041			$15,302,701			$13,642,353		
Interest-Bearing Liabilities									

Checking and NOW accounts	$3,146,309	$4,973	0.16	%	$2,676,760	$2,224	0.08	%	$2,389,143	$1,529	0.06	%
Savings accounts	2,995,484	7,464	0.25		2,964,875	4,980	0.17		2,595,622	3,723	0.14	
Money market accounts	1,225,220	4,424	0.36		762,540	831	0.11		763,909	840	0.11	
Time deposits	1,839,974	24,416	1.33		1,487,077	12,321	0.83		1,361,647	11,191	0.82	
Total interest-bearing deposits	9,206,987	41,277	0.45		7,891,252	20,356	0.26		7,110,321	17,283	0.24	
Federal funds purchased and interbank borrowings	238,408	4,793	2.01		187,426	1,966	1.05		137,997	673	0.49	
Securities sold under agreements to repurchase	344,964	1,962	0.57		336,539	1,270	0.38		368,757	1,509	0.41	
Federal Home Loan Bank advances	1,665,689	34,925	2.10		1,481,314	24,818	1.68		1,121,413	15,547	1.39	
Other borrowings	249,832	11,486	4.60		224,793	9,758	4.34		222,708	9,419	4.23	
Total interest-bearing liabilities	$11,705,880	$94,443	0.81	%	$10,121,324	$58,168	0.57	%	$8,961,196	$44,431	0.50	%
Noninterest-Bearing Liabilities												
Demand deposits	3,657,234				3,111,672				2,776,140			
Other liabilities	159,600				146,060				192,443			
Shareholders' equity	2,267,327				1,923,645				1,712,574			
Total liabilities and shareholders' equity	$17,790,041				$15,302,701				$13,642,353			
Interest Margin Recap												
Interest income/average earning assets		$643,439	4.15	%		$518,427	3.92	%		$468,427	3.96	%
Interest expense/average earning assets		94,443	0.61			58,168	0.44			44,431	0.38	
Net interest income and margin		$548,996	3.54	%		$460,259	3.48	%		$423,996	3.58	%

(1)

The 2018, 2017, and 2016 average balances include $31.0 million, $21.2 million, and $24.8 million, respectively, of required and excess balances held at the Federal Reserve.

(2) Changes in fair value are reflected in the average balance; however, yield information does not give effect to changes in fair value that are reflected as a component of shareholders' equity.

(3) Includes U.S. government-sponsored entities and agency mortgage-backed securities at December 31, 2018.

(4) Interest on state and political subdivision investment securities and commercial loans includes the effect of taxable equivalent adjustments of $7.1 million and $4.3 million, respectively, in 2018; $15.6 million and $7.5 million, respectively, in 2017; and $15.2 million and $6.1 million, respectively, in 2016; using the federal statutory tax rate in effect of 21% in 2018 and 35% in 2017 and 2016.

(5) Includes principal balances of nonaccrual loans. Interest income relating to nonaccrual loans is included only if received.

The yield on average earning assets increased 23 basis points from 3.92% in 2017 to 4.15% in 2018 and the cost of interest-bearing liabilities increased 24 basis points from 0.57% in 2017 to 0.81% in 2018. Average earning assets increased by $2.263 billion, or 17%. The increase in average earning assets consisted of a $1.896 billion increase in loans, a $354.6 million increase in lower yielding investment securities, and a $12.7 million increase in money market and other interest-earning investments. Average interest-bearing liabilities increased $1.585 billion, or 16%. The increase in average interest-bearing liabilities consisted of a $1.316 billion increase in interest-bearing deposits, a $51.0 million increase in federal funds purchased and interbank borrowings, an $8.4 million increase in securities sold under agreements to repurchase, a $184.4 million increase in FHLB advances, and a $25.0 million increase in other borrowings. Average noninterest-bearing deposits increased by $545.6 million.

The increase in average earning assets in 2018 compared to 2017 was primarily due to our acquisitions of Anchor (MN) in November 2017 and Klein in November 2018. Including loans held for sale, the loan portfolio, which generally has an average yield higher than the investment portfolio, was approximately 74% of average interest earning assets in 2018 compared to 72% in 2017.

Average loans including loans held for sale increased $1.896 billion in 2018 compared to 2017 reflecting loans acquired from Anchor (MN) in November 2017 and Klein in November 2018, along with organic loan growth. Loans including loans held for sale attributable to the Anchor (MN) acquisition totaled $1.595 billion as of the closing date of the acquisition, which was November 1, 2017. Loans including loans held for sale attributable to the Klein acquisition totaled $1.052 billion as of the closing date of the acquisition, which was November 1, 2018.

The increases in average investments and average deposits also reflected the Anchor (MN) and Klein acquisitions.

Average non-interest-bearing deposits increased $545.6 million in 2018 compared to 2017 reflecting the Anchor (MN) and Klein acquisitions. Average interest-bearing deposits increased $1.316 million in 2018 compared to 2017 reflecting the Anchor (MN) and Klein acquisitions.

Average borrowed funds increased $268.8 million in 2018 compared to 2017 primarily due to increased funding needed as a result of growth in our loan portfolio that outpaced deposit growth.

The following table shows fluctuations in taxable equivalent net interest income attributable to changes in the average balances of assets and liabilities and the yields earned or rates paid for the years ended December 31.

	From 2017 to 2018			From 2016 to 2017		
	Total	Attributed to		Total	Attributed to	
(dollars in thousands)	Change	Volume	Rate	Change	Volume	Rate
Interest Income						
Money market and other interest-earning investments	$372	$129	$243	$128	$16	$112
Investment securities (1)	6,428	10,208	(3,780)	6,682	3,960	2,722
Loans (1)	118,212	84,716	33,496	43,190	54,994	(11,804)
Total interest income	125,012	95,053	29,959	50,000	58,970	(8,970)
Interest Expense						
Checking and NOW deposits	2,749	566	2,183	695	212	483
Savings deposits	2,484	64	2,420	1,257	575	682
Money market deposits	3,593	1,087	2,506	(9)	(1)	(8)
Time deposits	12,095	3,804	8,291	1,130	1,035	95
Federal funds purchased and interbank borrowings	2,827	780	2,047	1,293	380	913
Securities sold under agreements to repurchase	692	40	652	(239)	(127)	(112)
Federal Home Loan Bank advances	10,107	3,478	6,629	9,271	5,510	3,761
Other borrowings	1,728	1,120	608	339	89	250
Total interest expense	36,275	10,939	25,336	13,737	7,673	6,064
Net interest income	$88,737	$84,114	$4,623	$36,263	$51,297	$(15,034)

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

(1) Interest on investment securities and loans includes the effect of taxable equivalent adjustments of $7.1 million and $4.3 million, respectively, in 2018; $15.6 million and $7.5 million, respectively, in 2017; and $15.2 million and $6.1 million, respectively, in 2016; using the federal statutory tax rate in effect of 21% in 2018 and 35% in 2017 and 2016.

Provision for Loan Losses

The provision for loan losses was an expense of $7.0 million in 2018, compared to an expense of $3.1 million in 2017. Net charge-offs totaled $1.9 million in 2018, compared to net charge-offs of $2.5 million in 2017. The higher provision for loan losses is the result of an increase in specific reserves on loans individually evaluated for impairment and loan growth, partially offset by lower incurred loss rate expectations. Continued loan growth in future periods, a decline in our current level of recoveries, or an increase in charge-offs could result in an increase in provision expense. For additional information about non-performing loans, charge-offs, and additional items impacting the provision, refer to the “Risk Management – Credit Risk” section of Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Noninterest Income

We generate revenues in the form of noninterest income through client fees, sales commissions, and other gains and losses from our core banking franchise and other related businesses, such as wealth management, investment consulting, and investment products. This source of revenue as a percentage of total revenue was 27% in 2018 compared to 30% in 2017.

The following table details the components of noninterest income for the years ended December 31.

	Years Ended December 31,			% Change From Prior Year	
(dollars in thousands)	2018	2017	2016	2018	2017
Wealth management fees	$36,863	$37,316	$34,641	(1.2)%	7.7 %
Service charges on deposit accounts	44,026	41,331	41,578	6.5	(0.6)
Debit card and ATM fees	20,216	17,676	16,769	14.4	5.4
Mortgage banking revenue	17,657	18,449	20,240	(4.3)	(8.8)
Insurance premiums and commissions	399	617	20,527	(35.3)	(97.0)
Investment product fees	20,539	20,977	18,822	(2.1)	11.4
Capital markets income	4,934	6,544	3,227	(24.6)	102.8
Company-owned life insurance	10,584	8,654	8,479	22.3	2.1
Net securities gains (losses)	2,060	9,135	5,848	(77.4)	56.2
Recognition of deferred gain on sale leaseback transactions	1,577	2,080	16,057	(24.2)	(87.0)
Net gain on branch divestitures	13,989	—	—	N/M	N/M
Gain on sale of ONB Insurance Group, Inc.	—	—	41,864	N/M	(100.0)
Other income	22,461	20,603	24,778	9.0	(16.8)
Total noninterest income	$195,305	$183,382	$252,830	6.5 %	(27.5)%
Noninterest income to total revenue (1)	26.2 %	28.5 %	37.4 %		

(1) Total revenue includes the effect of a taxable equivalent adjustment of $11.4 million in 2018, $23.1 million in 2017, and $21.3 million in 2016.

The increase in noninterest income in 2018 when compared to 2017 was primarily due to a $14.0 million gain on the sale of 10 Wisconsin branches and higher noninterest income attributable to the Anchor (MN) and Klein partnerships. This increase was partially offset by lower net securities gains and 2017 recoveries on loans originated by AnchorBank (WI) that had been fully charged-off prior to the acquisition totaling $4.0 million.

Service charges and overdraft fees increased $2.7 million in 2018 compared to 2017 primarily due to higher service charges and overdraft fees attributable to the Anchor (MN) and Klein partnerships, partially offset by lower overdraft charges.

Debit card and ATM fees increased $2.5 million in 2018 compared to 2017 primarily due to higher interchange income attributable to the Anchor (MN) and Klein partnerships.

Capital markets income is comprised of customer interest rate swap fees, debt placement fees, foreign currency exchange fees, and net gains (losses) on foreign currency adjustments. Capital markets income decreased $1.6 million in 2018 compared to 2017 primarily due to lower customer interest rate swap fees.

Company-owned life insurance income increased $1.9 million in 2018 compared to 2017 primarily due to higher settlements in 2018.

Net securities gains decreased $7.1 million in 2018 compared to 2017 primarily due to lower realized gains on sales of available-for-sale securities in 2018.

In 2018, we recorded a net gain of $14.0 million in connection with the October 2018 divestiture of 10 Wisconsin branches, which included a deposit premium of $15.0 million, goodwill allocation of $0.6 million, and $0.4 million of other transaction expenses.

Other income increased $1.9 million in 2018 when compared to 2017 reflecting a $2.2 million gain on the sale of our student loan portfolio in the second quarter of 2018 and higher other income attributable to the Anchor (MN) and Klein partnerships, partially offset by 2017 recoveries on loans originated by AnchorBank (WI) that had been fully charged-off prior to the acquisition totaling $4.0 million.

Noninterest Expense

The following table details the components of noninterest expense for the years ended December 31.

	Years Ended December 31,			% Change From Prior Year	
(dollars in thousands)	2018	2017	2016	2018	2017
Salaries and employee benefits	$281,275	$246,738	$252,892	14.0 %	(2.4)%
Occupancy	51,941	46,511	50,947	11.7	(8.7)
Equipment	14,861	13,560	13,448	9.6	0.8
Marketing	15,847	13,172	14,620	20.3	(9.9)
Data processing	36,170	32,306	32,002	12.0	0.9
Communication	10,846	9,284	9,959	16.8	(6.8)
Professional fees	14,503	16,840	15,705	(13.9)	7.2
Loan expense	7,028	6,596	7,632	6.5	(13.6)
Supplies	3,037	2,406	2,865	26.2	(16.0)
FDIC assessment	10,638	9,480	8,681	12.2	9.2
Other real estate owned expense	878	3,376	4,195	(74.0)	(19.5)
Amortization of intangibles	14,442	11,841	12,486	22.0	(5.2)
Amortization of tax credit investments	22,949	11,733	—	95.6	N/M
Other expense	32,846	24,993	28,715	31.4	(13.0)
Total noninterest expense	$517,261	$448,836	$454,147	15.2 %	(1.2)%

Noninterest expense increased $68.4 million in 2018 when compared to 2017 primarily due to higher operating expenses and acquisition and integration costs associated with Anchor (MN) and Klein. Also contributing to the increase in noninterest expense was higher amortization of tax credit investments in 2018 reflecting the completion of investment tax credit projects, higher salaries and benefits, and higher charitable contributions.

Salaries and benefits is the largest component of noninterest expense. Salaries and benefits increased $34.5 million in 2018 compared to 2017. Impacting salaries and benefits expense were the acquisitions of Anchor (MN) and Klein. Also contributing to the increase in salaries and benefits were higher incentive compensation expenses, hospitalization expenses, and profit sharing expenses. The increase in profit sharing expenses reflected Old National's increase in its 401(k) match to 75% of employee compensation deferral contributions of the first 4% of compensation, and 50% of the next 4% of compensation during the second quarter of 2018. The change was retroactive for all of 2018. For 2017, we matched 50% of employee compensation deferral contributions, up to 6% of compensation.

Occupancy expenses increased $5.4 million in 2018 compared to 2017 primarily due to higher occupancy expenses attributable to the Anchor (MN) and Klein partnerships and higher real estate taxes.

Marketing expense increased $2.7 million in 2018 compared to 2017 primarily due to additional expenses associated with the Anchor (MN) and Klein partnerships and higher public relations expense.

Data processing increased $3.9 million in 2018 compared to 2017 primarily due to integration expenses associated with the Anchor (MN) and Klein partnerships and higher software expenses.

Professional fees decreased $2.3 million in 2018 compared to 2017 primarily due to $3.5 million in pre-tax expenses recorded in 2017 related to an initiative to improve how we serve our clients and increase efficiency, partially offset by professional fees associated with the Klein partnership.

Amortization of tax credit investments was $22.9 million in 2018 compared to $11.7 million in 2017. The recognition of tax credit amortization expense is contingent upon the successful rehabilitation of a historic building or completion of a solar project within the reporting period. Many factors including weather, labor availability, building regulations, inspections, and other unexpected construction delays related to a rehabilitation project can cause a project to exceed its estimated completion date. Amortization of tax credit investments is expected to be de minimis in 2019. See Note 10 to the consolidated financial statements for additional information on our tax credit investments.

Other expense increased $7.9 million in 2018 compared to 2017 primarily due to higher charitable contributions of $6.3 million and higher other expense associated with the Anchor (MN) and Klein partnerships.

Provision for Income Taxes

We record a provision for income taxes currently payable and for income taxes payable or benefits to be received in the future, which arise due to timing differences in the recognition of certain items for financial statement and income tax purposes. The major difference between the effective tax rate applied to our financial statement income and the federal statutory tax rate is caused by a tax benefit from our tax credit investments and interest on tax-exempt securities and loans. The effective tax rate was 8.6% in 2018 compared to 43.3% in 2017. The lower effective tax rate in 2018 when compared to 2017 is the result of $39.3 million of additional tax expense recorded in 2017 for the revaluation of deferred tax assets due to the lowering of the federal corporate tax rate to 21% and an increase in federal tax credits available. See Note 16 to the consolidated financial statements for additional details on Old National’s income tax provision.

Comparison of Fiscal Years 2017 and 2016

In 2017, we generated net income of $95.7 million and diluted net income per share of $0.69 compared to $134.3 million and diluted net income per share of $1.05, respectively, in 2016. The 2017 earnings included a $69.4 million decrease in noninterest income, a $6.7 million increase in income tax expense, and a $2.1 million increase in provision for loan losses. These decreases to net income were partially offset by a $34.5 million increase in net interest income and a $5.3 million decrease in noninterest expense. The successful conversion and integration of our acquisition of Anchor (MN) in 2017, strong commercial and commercial real estate loan growth, consistently low credit metrics, and well-controlled noninterest expenses all contributed to positive 2017 performance when compared to 2016.

Net interest income was $437.2 million in 2017, a $34.5 million increase from $402.7 million in 2016. Taxable equivalent net interest income was $460.3 million in 2017, a 9% increase from $424.0 million in 2016. The net interest margin on a fully taxable equivalent basis was 3.48% in 2017, a 10 basis point decrease compared to 3.58% in 2016. Average earning assets increased by $1.397 billion during 2017 and the yield on average earning assets decreased 4 basis points from 3.96% in 2016 to 3.92% in 2017. Average interest-bearing liabilities increased $1.160 billion and the cost of interest-bearing liabilities increased 7 basis points from 0.50% in 2016 to 0.57% in 2017.

The provision for loan losses was an expense of $3.1 million in 2017, compared to an expense of $1.0 million in 2016. Charge-offs remained low during 2017 and we continued to see positive trends in credit quality.

Noninterest income decreased to $183.4 million in 2017 from $252.8 million in 2016 primarily due to a $41.9 million gain and lower insurance premiums and commissions in 2016 resulting from the sale of ONI in May 2016, partially offset by higher wealth management fees, investment product fees, and capital markets income in 2017.

Noninterest expense decreased $5.3 million to $448.8 million in 2017 from $454.1 million in 2016 primarily due to the reduction of costs associated with the divestiture of ONI in May 2016. Offsetting these decreases was $11.7 million of amortization of tax credit investments in 2017. In addition, noninterest expense in 2017 included $12.3 million of acquisition and integration costs associated with Anchor (MN), compared to $15.9 million in 2016 of acquisition and integration costs associated with Anchor (WI).

The provision for income taxes was $72.9 million in 2017 compared to $66.2 million in 2016. Old National’s effective tax rate was 43.3% in 2017 compared to 33.0% in 2016. The higher effective tax rate in 2017 when compared to 2016 is the result of $39.3 million of additional tax expense to estimate the revaluation of deferred tax assets due to the lowering of the federal corporate tax rate to 21%, partially offset by an increase in federal tax credits available.

FINANCIAL CONDITION

Overview

At December 31, 2018, our assets were $19.728 billion, a 13% increase compared to $17.518 billion at December 31, 2017. The increase was primarily due to the acquisition of Klein in November 2018, which had $2.157 billion in

assets as of the closing date of the acquisition, including goodwill of $208.0 million. Organic growth in our commercial loan portfolios also contributed to the increase in assets.

Earning Assets

Our earning assets are comprised of investment securities, portfolio loans, loans held for sale, money market investments, interest earning accounts with the Federal Reserve, and equity securities. Earning assets were $17.070 billion at December 31, 2018, an increase of 12% compared to $15.209 billion at December 31, 2017.

Investment Securities

We classify the majority of our investment securities as available-for-sale to give management the flexibility to sell the securities prior to maturity if needed, based on fluctuating interest rates or changes in our funding requirements. However, we also have $74.0 million of U.S. government-sponsored entities and agencies securities, $127.1 million of fixed-rate mortgage-backed securities, and $305.2 million of state and political subdivision securities in our held-to-maturity investment portfolio at December 31, 2018.

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

At December 31, 2018, the investment securities portfolio, including equity securities, was $4.778 billion compared to $4.006 billion at December 31, 2017, an increase of $772.8 million, or 19%. Investment securities attributable to the Klein acquisition totaled $700.6 million as of the closing date of the acquisition. Investment securities represented 28% of earning assets at December 31, 2018, compared to 26% at December 31, 2017. Stronger commercial loan demand in the future and management's decision to deleverage the balance sheet could result in a reduction in the securities portfolio. As of December 31, 2018, management does not intend to sell any securities in an unrealized loss position and does not believe we will be required to sell such securities.

The investment securities available-for-sale portfolio had net unrealized losses of $49.2 million at December 31, 2018, compared to net unrealized losses of $56.4 million at December 31, 2017. Net unrealized losses decreased from December 31, 2017 to December 31, 2018 reflecting higher net unrealized gains on state and political subdivision securities.

The investment portfolio had an effective duration of 4.00 at December 31, 2018, compared 4.15 at December 31, 2017. Effective duration measures the percentage change in value of the portfolio in response to a change in interest rates. Generally, there is more uncertainty in interest rates over a longer average maturity, resulting in a higher duration percentage. The weighted average yields on available-for-sale investment securities were 2.89% in 2018 and 2.43% in 2017. The average yields on the held-to-maturity portfolio were 3.75% in 2018 and 5.44% in 2017.

At December 31, 2018, Old National had a concentration of investment securities issued by certain states and their political subdivisions with the following aggregate market values: $344.4 million by Indiana, which represented 12.8% of shareholders' equity, and $176.0 million by Texas, which represented 6.5% of shareholders' equity. Of the Indiana municipal bonds, 99% are rated "A" or better, and the remaining 1% generally represent non-rated local interest bonds where Old National has a market presence. All of the Texas municipal bonds are rated "A" or better, and the majority of issues are backed by the "AAA" rated State of Texas Permanent School Fund Guarantee Program.

Loan Portfolio

We lend primarily to consumers and small to medium-sized commercial and commercial real estate clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling, and retailing. Our policy is to concentrate our lending activity in the geographic market areas we serve, primarily Indiana, Kentucky, Michigan, Wisconsin, and Minnesota.

The following table presents the composition of the loan portfolio at December 31.

(dollars in thousands)	2018	2017	2016	2015	2014	Four- Year Growth Rate	
Commercial	$3,232,970	$2,717,269	$1,917,099	$1,814,940	$1,646,767	18.4	%
Commercial real estate	4,958,851	4,354,552	3,130,853	1,868,972	1,751,907	29.7	
Consumer	1,803,667	1,879,247	1,875,030	1,603,158	1,379,117	6.9	
Total loans excluding residential real estate	9,995,488	8,951,068	6,922,982	5,287,070	4,777,791	20.3	
Residential real estate	2,248,404	2,167,053	2,087,530	1,661,335	1,540,410	9.9	
Total loans	12,243,892	11,118,121	9,010,512	6,948,405	6,318,201	18.0	%
Less: Allowance for loan losses	55,461	50,381	49,808	52,233	47,849		
Net loans	$12,188,431	$11,067,740	$8,960,704	$6,896,172	$6,270,352		

Commercial and Commercial Real Estate Loans

At December 31, 2018, commercial and commercial real estate loans were $8.192 billion, an increase of $1.120 billion, or 16%, compared to December 31, 2017. Commercial and commercial real estate loans attributable to the Klein acquisition totaled $836.8 million as of the closing date of the acquisition. Excluding these acquired loans, commercial and commercial real estate loans grew 4% in 2018.

The following table presents the maturity distribution and rate sensitivity of commercial loans at December 31, 2018 and an analysis of these loans that have predetermined and floating interest rates.

(dollars in thousands)	Within 1 Year	1 - 5 Years	Beyond 5 Years	Total	% of Total	
Interest rates:						
Predetermined	$183,669	$866,138	$619,329	$1,669,136	52	%
Floating	771,332	506,598	285,904	1,563,834	48	
Total	$955,001	$1,372,736	$905,233	$3,232,970	100	%

Residential Real Estate Loans

Residential real estate loans, primarily 1-4 family properties, increased $81.4 million, or 4%, at December 31, 2018 compared to December 31, 2017. Residential real estate loans attributable to the Klein acquisition totaled $77.7 million as of the closing date of the acquisition. Future increases in interest rates could result in a decline in the level of refinancings and new originations of residential real estate loans.

Consumer Loans

Consumer loans, including automobile loans, personal and home equity loans and lines of credit, and student loans, decreased $75.6 million at December 31, 2018 compared to December 31, 2017. Old National assumed student loans in the acquisition of Anchor (WI) in May 2016. Student loans are guaranteed by the government from 97% to 100% and totaled $68.2 million at December 31, 2017. Old National sold the remaining student loan portfolio totaling $64.9 million during the second quarter of 2018, resulting in a $2.2 million gain that is included in other income on the income statement. Consumer loans attributable to the Klein acquisition totaled $134.6 million as of the closing date of the acquisition. We continue to see runoff in our less profitable indirect consumer loan portfolio.

Allowance for Loan Losses

To provide for the risk of loss inherent in extending credit, we maintain an allowance for loan losses. The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses incurred in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience. Additional information about our Allowance for Loan Losses is included in the "Risk Management – Credit Risk" section of Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Notes 1 and 5 to the consolidated financial statements.

At December 31, 2018, the allowance for loan losses was $55.5 million, an increase of $5.1 million compared to $50.4 million at December 31, 2017. Continued loan growth in future periods, a decline in our current level of recoveries, or an increase in charge-offs could result in an increase in provision expense. As a percentage of total loans excluding loans held for sale, the allowance was 0.45% at December 31, 2018 and December 31, 2017. The Klein acquisition added $1.049 billion of loans. In accordance with ASC 805, no allowance for loan losses is recorded at the date of acquisition and a reserve is only established to absorb any subsequent credit deterioration or adverse changes in expected cash flows. The provision for loan losses was an expense of $7.0 million in 2018 compared to an expense of $3.1 million in 2017.

For commercial loans, the allowance for loan losses increased by $2.5 million at December 31, 2018 compared to December 31, 2017. The allowance for loan losses as a percentage of the commercial loan portfolio decreased to 0.67% at December 31, 2018, from 0.71% at December 31, 2017.

For commercial real estate loans, the allowance for loan losses increased by $2.0 million at December 31, 2018 compared to December 31, 2017. The allowance for loan losses as a percentage of the commercial real estate loan portfolio decreased to 0.47% at December 31, 2018, from 0.49% at December 31, 2017.

The allowance for loan losses for residential real estate loans as a percentage of that portfolio increased to 0.10% at December 31, 2018, from 0.08% at December 31, 2017. The allowance for loan losses for consumer loans as a percentage of that portfolio increased to 0.44% at December 31, 2018, from 0.42% at December 31, 2017.

Allowance for Losses on Unfunded Commitments

We maintain an allowance for losses on unfunded commercial lending commitments and letters of credit to provide for the risk of loss inherent in these arrangements. The allowance is computed using a methodology similar to that used to determine the allowance for loan losses, modified to take into account the probability of a drawdown on the commitment. This allowance is classified as a liability on the balance sheet within accrued expenses and other liabilities, while the corresponding provision for these loan losses is recorded as a component of other expense. The allowance for losses on unfunded commitments was $2.5 million at December 31, 2018, compared to $3.1 million at December 31, 2017.

Loans Held for Sale

Mortgage loans held for immediate sale in the secondary market were $14.9 million at December 31, 2018, compared to $17.9 million at December 31, 2017. Certain mortgage loans are committed for sale at or prior to origination at a contracted price to an outside investor. Other mortgage loans held for immediate sale are hedged with TBA forward agreements and committed for sale when they are ready for delivery and remain on the Company's balance sheet for a short period of time (typically 30 to 60 days). These loans are sold without recourse, beyond customary representations and warranties, and Old National has not experienced material losses arising from these sales. Mortgage originations are subject to volatility due to interest rates and home sales, among other factors.

We have elected the fair value option under FASB ASC 825-10 prospectively for residential loans held for sale. The aggregate fair value exceeded the unpaid principal balance by $0.5 million as of December 31, 2018 and December 31, 2017.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets at December 31, 2018 totaled $1.113 billion, an increase of $232.1 million compared to $881.1 million at December 31, 2017. During 2018, we recorded $247.1 million of goodwill and other

intangible assets associated with the acquisition of Klein.

Net Deferred Tax Assets

Net deferred tax assets decreased $23.8 million since December 31, 2017 primarily due to a decrease in alternative minimum tax credit deferred tax assets. Old National reclassified $21.5 million from deferred tax assets related to alternative minimum tax credits to accrued income taxes in 2018 as a result of the enactment of the Tax Cuts and Jobs Act. Future changes in the corporate tax rate could result in a change in value of Old National's deferred tax assets and future income tax expense. See Note 16 to the consolidated financial statements for additional information.

Other Assets

Other assets increased $23.6 million, or 15%, since December 31, 2017 primarily due to higher accrued income taxes. Old National reclassified $21.5 million from deferred tax assets related to alternative minimum tax credits to accrued income taxes in 2018 as a result of the enactment of the Tax Cuts and Jobs Act. See Note 16 to the consolidated financial statements for additional information.

Funding

Total funding, comprised of deposits and wholesale borrowings, was $16.844 billion at December 31, 2018, an increase of $1.660 billion from $15.184 billion at December 31, 2017. Total deposits were $14.350 billion, including $12.326 billion in transaction accounts and $2.024 billion in time deposits at December 31, 2018. Total deposits increased $1.744 billion, or 14%, compared to December 31, 2017. Deposits attributable to the Klein acquisition totaled $1.713 billion as of the closing date of the acquisition. Noninterest-bearing demand deposits increased $284.6 million from December 31, 2017 to December 31, 2018. Interest-bearing checking and NOW deposits increased $672.5 million from December 31, 2017 to December 31, 2018, while savings deposits decreased $91.5 million. Money market deposits increased $488.8 million from December 31, 2017 to December 31, 2018, while time deposits increased $389.8 million.

We use wholesale funding to augment deposit funding and to help maintain our desired interest rate risk position. At December 31, 2018, wholesale borrowings, including federal funds purchased and interbank borrowings, securities sold under agreements to repurchase, FHLB advances, and other borrowings, totaled $2.494 billion, a decrease of $84.4 million, or 3%, from December 31, 2017. The decrease in wholesale funding from December 31, 2017 to December 31, 2018 was primarily due to a decrease in federal funds purchased and interbank borrowings and securities sold under agreements to repurchase. Wholesale funding as a percentage of total funding was 15% at December 31, 2018, compared to 17% at December 31, 2017. See Notes 12, 13, and 14 to the consolidated financial statements for additional details on our financing activities.

The following table details the average balances of all funding sources for the years ended December 31.

				% Change From Prior Year	
(dollars in thousands)	2018	2017	2016	2018	2017
Demand deposits	$3,657,234	$3,111,672	$2,776,140	17.5 %	12.1 %
Interest-bearing checking and NOW deposits	3,146,309	2,676,760	2,389,143	17.5	12.0
Savings deposits	2,995,484	2,964,875	2,595,622	1.0	14.2
Money market deposits	1,225,220	762,540	763,909	60.7	(0.2)
Time deposits	1,839,974	1,487,077	1,361,647	23.7	9.2
Total deposits	12,864,221	11,002,924	9,886,461	16.9	11.3
Federal funds purchased and interbank borrowings	238,408	187,426	137,997	27.2	35.8
Securities sold under agreements to repurchase	344,964	336,539	368,757	2.5	(8.7)
Federal Home Loan Bank advances	1,665,689	1,481,314	1,121,413	12.4	32.1
Other borrowings	249,832	224,793	222,708	11.1	0.9
Total funding sources	$15,363,114	$13,232,996	$11,737,336	16.1 %	12.7 %

The following table presents a maturity distribution for certificates of deposit with denominations of $100,000 or more at December 31.

		Maturity Distribution			
	Year-End	1-90	91-180	181-365	Beyond
(dollars in thousands)	Balance	Days	Days	Days	1 Year
2018	$1,133,130	$397,990	$265,232	$280,402	$189,506
2017	727,496	265,872	109,584	171,877	180,163
2016	544,803	142,806	91,704	115,151	195,142

Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities increased $15.2 million, or 8%, from December 31, 2017 primarily due an increase in accrued expenses attributable to the Klein acquisition.

Capital

Shareholders' equity totaled $2.690 billion, or 14% of total assets, at December 31, 2018 and $2.154 billion, or 12% of total assets, at December 31, 2017. Shareholders' equity at December 31, 2018 included $406.5 million from the 22.8 million shares of Common Stock that were issued in conjunction with the acquisition of Klein. We paid cash dividends of $0.52 per share in 2018, which reduced equity by $82.2 million. Old National's Common Stock is traded on the NASDAQ under the symbol "ONB" with 34,536 shareholders of record at December 31, 2018.

Capital Adequacy

Old National and the banking industry are subject to various regulatory capital requirements administered by the federal banking agencies. Management routinely analyzes Old National's capital to ensure an optimized capital structure. Accordingly, such evaluations may result in Old National taking a capital action. For additional information on capital adequacy see Note 25 to the consolidated financial statements.

RISK MANAGEMENT

Overview

Old National has adopted a Risk Appetite Statement to enable the Board of Directors, Executive Leadership Group, and Senior Management to better assess, understand, and mitigate the risks of Old National. The Risk Appetite Statement addresses the following major risks: strategic, market, liquidity, credit, operational/technology/cyber, regulatory/compliance/legal, reputational, and human resources. Our Chief Risk Officer is independent of management and reports directly to the Chair of the Board's Enterprise Risk Management Committee. The following discussion addresses these major risks: credit, market, liquidity, operational/technology/cyber, and regulatory/compliance/legal.

Credit Risk

Credit risk represents the risk of loss arising from an obligor's inability or failure to meet contractual payment or performance terms. Our primary credit risks result from our investment and lending activities.

Investment Activities

We carry a higher exposure to loss in our pooled trust preferred securities, which are collateralized debt obligations, due to illiquidity in that market and the performance of the underlying collateral. At December 31, 2018, we had pooled trust preferred securities with a fair value of $8.5 million, or less than 1% of the available-for-sale securities portfolio. These securities remained classified as available-for-sale and at December 31, 2018, the unrealized loss on our pooled trust preferred securities was approximately $5.4 million. The fair value of these securities should improve as we get closer to maturity, but not in all cases. During the first quarter of 2018, Old National sold a pooled trust security for proceeds of $1.8 million, which resulted in a loss of $0.9 million. There was no OTTI recorded in 2018 or 2017.

All of our mortgage-backed securities are backed by U.S. government-sponsored or federal agencies. Municipal bonds, corporate bonds, and other debt securities are evaluated by reviewing the credit-worthiness of the issuer and general market conditions. See Note 3 to the consolidated financial statements for additional details about our investment security portfolio.

Counterparty Exposure

Counterparty exposure is the risk that the other party in a financial transaction will not fulfill its obligation. We define counterparty exposure as nonperformance risk in transactions involving federal funds sold and purchased, repurchase agreements, correspondent bank relationships, and derivative contracts with companies in the financial services industry. Old National manages exposure to counterparty risk in connection with its derivatives transactions by generally engaging in transactions with counterparties having ratings of at least A by Standard & Poor's Rating Service or A2 by Moody's Investors Service. Total credit exposure is monitored by counterparty and managed within limits that management believes to be prudent. Old National's net counterparty exposure was an asset of $396.4 million at December 31, 2018.

Lending Activities

Commercial

Commercial and industrial loans are made primarily for the purpose of financing equipment acquisition, expansion, working capital, and other general business purposes. Lease financing consists of direct financing leases and are used by commercial customers to finance capital purchases ranging from computer equipment to transportation equipment. The credit decisions for these transactions are based upon an assessment of the overall financial capacity of the applicant. A determination is made as to the applicant's ability to repay in accordance with the proposed terms as well as an overall assessment of the risks involved. In addition to an evaluation of the applicant's financial condition, a determination is made of the probable adequacy of the primary and secondary sources of repayment, such as additional collateral or personal guarantees, to be relied upon in the transaction. Credit agency reports of the applicant's credit history supplement the analysis of the applicant's creditworthiness.

Commercial mortgages and construction loans are offered to real estate investors, developers, and builders primarily domiciled in the geographic market areas we serve: Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. These loans are secured by first mortgages on real estate at LTV margins deemed appropriate for the property type, quality, location, and sponsorship. Generally, these LTV ratios do not exceed 80%. The commercial properties are predominantly non-residential properties such as retail centers, apartments, industrial properties and, to a lesser extent, more specialized properties. Substantially all of our commercial real estate loans are secured by properties located in our primary market area.

In the underwriting of our commercial real estate loans, we obtain appraisals for the underlying properties. Decisions to lend are based on the economic viability of the property and the creditworthiness of the borrower. In evaluating a proposed commercial real estate loan, we primarily emphasize the ratio of the property's projected net cash flows to the loan's debt service requirement. The debt service coverage ratio normally is not less than 120% and it is computed after deduction for a vacancy factor and property expenses as appropriate. In addition, a personal guarantee of the loan or a portion thereof is often required from the principal(s) of the borrower. In most cases, we require title insurance insuring the priority of our lien, fire, and extended coverage casualty insurance, and flood insurance, if appropriate, in order to protect our security interest in the underlying property. In addition, business interruption insurance or other insurance may be required.

Construction loans are underwritten against projected cash flows derived from rental income, business income from an owner-occupant, or the sale of the property to an end-user. We may mitigate the risks associated with these types of loans by requiring fixed-price construction contracts, performance and payment bonding, controlled disbursements, and pre-sale contracts or pre-lease agreements.

Consumer

We offer a variety of first mortgage and junior lien loans to consumers within our markets, with residential home mortgages comprising our largest consumer loan category. These loans are secured by a primary residence and are underwritten using traditional underwriting systems to assess the credit risks of the consumer. Decisions are primarily based on LTV ratios, DTI ratios, liquidity, and credit scores. A maximum LTV ratio of 80% is generally required, although higher levels are permitted with mortgage insurance or other mitigating factors. We offer fixed rate mortgages and variable rate mortgages with interest rates that are subject to change every year after the first, third, fifth, or seventh year, depending on the product and are based on fully-indexed rates such as LIBOR. We do not offer payment-option facilities, sub-prime loans, or any product with negative amortization.

Home equity loans are secured primarily by second mortgages on residential property of the borrower. The underwriting terms for the home equity product generally permits borrowing availability, in the aggregate, up to 90% of the appraised value of the collateral property at the time of origination. We offer fixed and variable rate home equity loans, with variable rate loans underwritten at fully-indexed rates. Decisions are primarily based on LTV ratios, DTI ratios, and credit scores. We do not offer home equity loan products with reduced documentation.

Automobile loans include loans and leases secured by new or used automobiles. We originate automobile loans and leases primarily on an indirect basis through selected dealerships. We require borrowers to maintain collision insurance on automobiles securing consumer loans, with us listed as loss payee. Our procedures for underwriting automobile loans include an assessment of an applicant's overall financial capacity, including credit history and the ability to meet existing obligations and payments on the proposed loan. Although an applicant's creditworthiness is

the primary consideration, the underwriting process also includes a comparison of the value of the collateral security to the proposed loan amount.

Old National assumed student loans in the acquisition of Anchor (WI) in May 2016. Student loans are guaranteed by the government from 97% to 100% and totaled $68.2 million at December 31, 2017. Old National sold the remaining student loan portfolio totaling $64.9 million during the second quarter of 2018, resulting in a $2.2 million gain that is included in other income on the income statement.

Asset Quality

Community-based lending personnel, along with region-based independent underwriting and analytic support staff, extend credit under guidelines established and administered by our Enterprise Risk Committee. This committee, which meets quarterly, is made up of outside directors. The committee monitors credit quality through its review of information such as delinquencies, credit exposures, peer comparisons, problem loans, and charge-offs. In addition, the committee reviews and approves recommended loan policy changes to assure it remains appropriate for the current lending environment.

We lend to commercial and commercial real estate clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling, and retailing. Old National manages concentrations of credit exposure by industry, product, geography, customer relationship, and loan size. At December 31, 2018, our average commercial loan size was under $400,000 and our average commercial real estate loan size was under $600,000. In addition, while loans to lessors of both residential and non-residential real estate exceed 10% of total loans, no individual sub-segment category within those broader categories reaches the 10% threshold. At December 31, 2018, we had minimal exposure to foreign borrowers and no sovereign debt. Our policy is to concentrate our lending activity in the geographic market areas we serve, primarily Indiana, Kentucky, Michigan, Wisconsin, and Minnesota. We are experiencing a slow and gradual improvement in the economy of our principal markets. Management expects that trends in under-performing, criticized, and classified loans will be influenced by the degree to which the economy strengthens or weakens.

On November 1, 2018, Old National closed on its acquisition of Klein. As of the closing date of the acquisition, loans totaled $1.049 billion and other real estate owned totaled $1.0 million. In accordance with accounting for business combinations, there was no allowance brought forward on any of the acquired loans, as the credit losses evident in the loans were included in the determination of the fair value of the loans at the acquisition date. Old National reviewed the acquired loans and determined that as of December 31, 2018, $46.3 million met the definition of criticized and $56.6 million were considered classified (of which $14.6 million are reported with nonaccrual loans). Our current preference would be to work these loans and avoid foreclosure actions unless additional credit deterioration becomes apparent. These acquired impaired loans are included in our summary of under-performing, criticized, and classified assets found below.

Summary of under-performing, criticized, and classified assets at December 31:

(dollars in thousands)	2018	2017	2016	2015	2014
Nonaccrual loans:					
Commercial	$38,648	$27,202	$56,585	$57,536	$38,460
Commercial real estate	86,601	62,425	44,026	47,350	67,402
Residential real estate	24,954	22,171	17,674	14,953	13,968
Consumer	7,281	13,129	13,122	5,198	5,903
Covered loans (1)	—	—	—	7,336	15,124
Total nonaccrual loans (2)	157,484	124,927	131,407	132,373	140,857
Renegotiated loans not on nonaccrual:					
Noncovered loans	17,356	19,589	14,376	14,147	12,710
Covered loans (1)	—	—	—	138	148
Past due loans (90 days or more and still accruing):					
Commercial	52	144	23	565	33
Commercial real estate	40	—	—	—	138
Residential real estate	258	—	2	114	1
Consumer	1,003	750	303	227	286
Covered loans (1)	—	—	—	10	—
Total past due loans	1,353	894	328	916	458
Other real estate owned	3,232	8,810	18,546	7,594	7,241
Other real estate owned, covered (1)	—	—	—	4,904	9,121
Total under-performing assets	$179,425	$154,220	$164,657	$160,072	$170,535
Classified loans (includes nonaccrual, renegotiated, past due 90 days, and other problem loans)	$334,785	$226,583	$220,429	$204,710	$233,486
Classified loans, covered (1)	—	—	—	8,584	17,413
Other classified assets (3)	2,820	4,556	7,063	6,857	14,752
Criticized loans	238,752	188,085	95,462	132,898	194,809
Criticized loans, covered (1)	—	—	—	1,449	4,525
Total criticized and classified assets	$576,357	$419,224	$322,954	$354,498	$464,985
Asset Quality Ratios including covered assets:					
Non-performing loans/total loans (4) (5)	1.43 %	1.30 %	1.62 %	2.11 %	2.43 %
Under-performing assets/total loans and other real estate owned (4)	1.47	1.39	1.82	2.30	2.69
Under-performing assets/total assets	0.91	0.88	1.11	1.33	1.46
Allowance for loan losses/under-performing assets (6)	30.91	32.67	30.25	32.63	28.06
Allowance for loan losses/nonaccrual loans (2)	35.22	40.33	37.90	39.46	33.97

(1) Old National entered into separate loss sharing agreements with the FDIC providing for specified credit loss protection for substantially all acquired single family residential loans, commercial loans, and other real estate owned. On June 22, 2016, Old National entered into an early termination agreement with the FDIC that terminated all loss share agreements. Old National reclassified all covered assets to noncovered assets effective June 22, 2016.

(2) Includes approximately $20.5 million, $12.6 million, $16.7 million, $15.9 million, and $41.2 million for 2018, 2017, 2016, 2015, and 2014, respectively, of purchased credit impaired loans that are categorized as nonaccrual for credit analysis purposes because the collection of principal or interest is doubtful. However, these loans are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.
(3) Includes 1 pooled trust preferred securities and 1 insurance policy at December 31, 2018.
(4) Loans exclude loans held for sale.
(5) Non-performing loans include nonaccrual and renegotiated loans.
(6) Because the acquired loans were recorded at fair value in accordance with ASC 805 at the date of acquisition, the credit risk is incorporated in the fair value recorded. No allowance for loan losses is recorded on the acquisition date.

Under-performing assets totaled $179.4 million at December 31, 2018, compared to $154.2 million at December 31, 2017. Under-performing assets as a percentage of total loans and other real estate owned at December 31, 2018 were 1.47%, an 8 basis point increase from 1.39% at December 31, 2017.

Nonaccrual loans increased $32.6 million from December 31, 2017 to December 31, 2018 primarily due to an increase in nonaccrual commercial and commercial real estate loans. Nonaccrual loans at December 31, 2018 include $14.6 million of loans related to the Klein acquisition. As a percentage of nonaccrual loans, the allowance for loan losses was 35.22% at December 31, 2018, compared to 40.33% at December 31, 2017. PCI loans that were included in the nonaccrual category because the collection of principal or interest is doubtful totaled $20.5 million at December 31, 2018, compared to $12.6 million at December 31, 2017. However, they are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.

Interest income of approximately $5.6 million and $6.7 million would have been recorded on nonaccrual and renegotiated loans outstanding at December 31, 2018 and 2017, respectively, if such loans had been accruing interest throughout the year in accordance with their original terms. Excluding PCI loans accounted for under ASC 310-30, the amount of interest income actually recorded on nonaccrual and renegotiated loans was $2.8 million in 2018 and $1.6 million in 2017. We had $26.3 million of renegotiated loans which are included in nonaccrual loans at December 31, 2018, compared to $34.0 million at December 31, 2017.

Total criticized and classified assets were $576.4 million at December 31, 2018, an increase of $157.1 million from December 31, 2017. Other classified assets include investment securities that fell below investment grade rating totaling $2.8 million at December 31, 2018, compared to $4.6 million at December 31, 2017.

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

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

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

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

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

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

At December 31, 2018, our TDRs consisted of $10.3 million of commercial loans, $27.6 million of commercial real estate loans, $3.4 million of residential loans, and $2.4 million of consumer loans totaling $43.7 million. Approximately $26.3 million of the TDRs at December 31, 2018 were included with nonaccrual loans. At

December 31, 2017, our TDRs consisted of $12.1 million of commercial loans, $34.7 million of commercial real estate loans, $3.3 million of residential loans, and $3.9 million of consumer loans totaling $54.0 million. Approximately $34.0 million of the TDRs at December 31, 2017 were included with nonaccrual loans.

Old National has allocated specific reserves to customers whose loan terms have been modified in TDRs totaling $3.0 million at December 31, 2018 and $5.7 million at December 31, 2017. As of December 31, 2018, Old National had committed to lend an additional $4.4 million to customers with outstanding loans that are classified as TDRs.

The terms of certain other loans were modified during 2018 that did not meet the definition of a TDR. It is our process to review all classified and criticized loans that, during the period, have been renewed, have entered into a

forbearance agreement, have gone from principal and interest to interest only, or have extended the maturity date. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on its debt in the foreseeable future without the modification. The evaluation is performed under our internal underwriting policy. We also evaluate whether a concession has been granted or if we were adequately compensated through a market interest rate, additional collateral, or a bona fide guarantee. We also consider whether the modification was insignificant relative to the other terms of the agreement or the delay in a payment.

PCI loans are not considered impaired until after the point at which there has been a degradation of cash flows below our expected cash flows at acquisition. If a PCI loan is subsequently modified, and meets the definition of a TDR, it will be removed from PCI accounting and accounted for as a TDR only if the PCI loan was being accounted for individually. If the PCI loan is being accounted for as part of a pool, it will not be removed from the pool. At December 31, 2018, it has not been necessary to remove any loans from PCI accounting.

In general, once a modified loan is considered a TDR, the loan will always be considered a TDR, and therefore impaired, until it is paid in full, otherwise settled, sold, or charged off. However, guidance also permits for loans to be removed from TDR status when subsequently restructured under these circumstances: (1) at the time of the subsequent restructuring, the borrower is not experiencing financial difficulties, and this is documented by a current credit evaluation at the time of the restructuring, (2) under the terms of the subsequent restructuring agreement, the institution has granted no concession to the borrower; and (3) the subsequent restructuring agreement includes market terms that are no less favorable than those that would be offered for a comparable new loan. For loans subsequently restructured that have cumulative principal forgiveness, the loan should continue to be measured in accordance with ASC 310-10, Receivables – Overall. However, consistent with ASC 310-40-50-2, Troubled Debt Restructurings by Creditors, Creditor Disclosure of Troubled Debt Restructurings, the loan would not be required to be reported in the years following the restructuring if the subsequent restructuring meets both of these criteria: (1) has an interest rate at the time of the subsequent restructuring that is not less than a market interest rate; and (2) is performing in compliance with its modified terms after the subsequent restructuring.

To provide for the risk of loss inherent in extending credit, we maintain an allowance for loan losses. The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses incurred in the consolidated loan portfolio. Management’s evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, assessments of the impact of current and anticipated economic conditions on the portfolio, and historical loss experience.

The activity in our allowance for loan losses was as follows:

(dollars in thousands)	2018	2017	2016	2015	2014
Balance at beginning of period	$50,381	$49,808	$52,233	$47,849	$47,145
Loans charged-off:					
Commercial	3,087	1,108	5,047	3,513	3,535
Commercial real estate	879	3,700	2,632	1,921	3,647
Residential real estate	1,100	985	800	1,039	793
Consumer credit	7,903	6,924	6,131	6,404	4,675
Total charge-offs	12,969	12,717	14,610	12,877	12,650
Recoveries on charged-off loans:					
Commercial	1,519	2,281	3,102	5,218	3,125
Commercial real estate	2,740	3,777	4,763	4,685	3,871

Residential real estate	2,118	255	174	354	205
Consumer credit	4,706	3,927	3,186	4,081	3,056
Total recoveries	11,083	10,240	11,225	14,338	10,257
Net charge-offs (recoveries)	1,886	2,477	3,385	(1,461)	2,393
Provision for loan losses	6,966	3,050	960	2,923	3,097
Balance at end of period	$55,461	$50,381	$49,808	$52,233	$47,849
Average loans for the year (1)	$11,422,967	$9,525,888	$8,265,169	$6,756,135	$