

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

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2018

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-35272

**MIDLAND STATES BANCORP, INC.**

(Exact name of Registrant as specified in its charter)

**ILLINOIS**

(State of other jurisdiction of incorporation or organization)

**37-1233196**

(I.R.S. Employer Identification No.)

**1201 Network Centre Drive, Effingham, IL**

(Address of principal executive offices)

**62401**

(Zip Code)

**(217) 342-7321**

(Registrant's telephone number, including area code)

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

<u>Title of Each Class</u>	<u>Name of each exchange on which registered</u>
<b>Common Stock, \$0.01 par value</b>	<b>Nasdaq Global Select Market</b>

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 (§232.405 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 (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of 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, 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 and non-voting common equity held by non-affiliates on June 29, 2018 was \$728,830,258 (based on the closing price on the Nasdaq Global Select Market on that date of \$34.26).

As of February 20, 2019, the Registrant had 24,050,292 shares of outstanding common stock, \$0.01 par value.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held May 3, 2019 to be filed within 120 days after December 31, 2018, are incorporated by reference into Part III of this Form 10-K.

**MIDLAND STATES BANCORP, INC.**  
**2018 ANNUAL REPORT ON FORM 10-K**  
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***Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995***

This Annual Report on Form 10-K contains certain “forward-looking statements” within the meaning of, and are intended to be covered by the safe harbor provisions of, the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as “may,” “might,” “should,” “could,” “predict,” “potential,” “believe,” “expect,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “goal,” “target,” “outlook,” “aim,” and “would” or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management’s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, estimates and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

A number of important factors could cause our actual results to differ materially from those indicated in these forward-looking statements, including those factors identified in “Item 1A – Risk Factors” or “Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations” or the following:

- business and economic conditions, particularly those affecting the financial services industry and our primary market areas;
- our ability to successfully manage our credit risk and the sufficiency of our allowance for loan loss;
- the failure of assumptions underlying the establishment of allowances for loan losses and estimation of values of collateral and various financial assets and liabilities;
- factors that can impact the performance of our loan portfolio, including real estate values and liquidity in our primary market areas, the financial health of our commercial borrowers and the success of construction projects that we finance, including any loans acquired in acquisition transactions;
- our management’s ability to reduce and effectively manage interest rate risk and the impact of interest rates, in general, on the volatility of our net interest income;
- compliance with governmental and regulatory requirements, including the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), the Basel III rules and others relating to banking, consumer protection, securities and tax matters, and our ability to maintain licenses required in connection with commercial mortgage origination, sale and servicing operations;
- legislative and regulatory changes, including changes in banking, consumer protection securities, trade and tax laws and regulations and their application by our regulators;
- our ability to identify and address cyber-security risks, fraud and systems errors;
- our ability to effectively execute our strategic plan and manage our growth;
- our ability to adapt successfully to technological changes to compete effectively in the marketplace;
- risks related to our acquisition strategy, including our ability to identify suitable acquisition candidates, exposure to potential asset and credit quality risks and unknown or contingent liabilities, the time and costs of integrating systems, procedures and personnel, the need for capital to finance such transactions, and possible failures in realizing the anticipated benefits from acquisitions;
- the effects of the accounting treatment for loans acquired in connection with our acquisitions;
- changes in our senior management team and our ability to attract, motivate and retain qualified personnel;
- monetary and fiscal policies of the U.S. government, including policies of the U.S. Department of the Treasury (“Treasury”) and the Board of Governors of the Federal Reserve System (the “Federal Reserve”), and changes in market interest rates;

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- liquidity issues, including fluctuations in the fair value and liquidity of the securities we hold for sale and our ability to raise additional capital, if necessary;
- the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services and demand for financial services in our market areas;
- changes in federal tax law or policy;
- the quality and composition of our loan and investment portfolios and the valuation of our investment portfolio;
- demand for loan products and deposit flows;
- the costs, effects and outcomes of existing or future litigation; and
- changes in accounting principles, policies and guidelines.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this report. In addition, our past results of operations are not necessarily indicative of our future results. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

## **PART I**

### **Item 1 – Business**

#### **Our Company**

Midland States Bancorp, Inc. (“the Company,” “we,” “our,” or “us”), an Illinois corporation formed in 1988, is a diversified financial holding company headquartered in Effingham, Illinois. The Company completed its initial public offering on May 24, 2016. Our banking subsidiary, Midland States Bank (the “Bank”), an Illinois state-chartered bank formed in 1881, has branches across Illinois and in Missouri, and provides a full range of commercial and consumer banking products and services, business equipment financing, merchant credit card services, trust and investment management, and insurance and financial planning services. In addition, multifamily and healthcare facility Federal Housing Administration (“FHA”) financing is provided through Love Funding Corporation (“Love Funding”), our non-bank subsidiary. As of December 31, 2018, the Company had total assets of \$5.64 billion, and our wealth management group had assets under administration of approximately \$2.95 billion.

Our strategic plan is focused on building a performance-based, customer-centric culture, seeking accretive acquisitions, creating revenue diversification, achieving operational excellence and maintaining a robust enterprise-wide risk management program. Over the past several years, we have grown organically and through a series of acquisitions, with an over-arching focus on enhancing shareholder value and building a platform for scalability. Most recently, on February 28, 2018, the Company completed its acquisition of Alpine Bancorporation, Inc. (“Alpine”) and its banking subsidiary, Alpine Bank & Trust Co. (“Alpine Bank”). As of February 28, 2018, Alpine had total assets of \$1.24 billion, gross loans of \$786.2 million and total deposits of \$1.11 billion. In addition, on June 9, 2017, the Company completed its acquisition of Centru Financial Corporation (“Centru”) and its banking subsidiary, Centru Bank. As of June 9, 2017, Centru had total assets of \$990.2 million, loans of \$679.6 million and deposits of \$739.9 million. We also acquired CedarPoint Investment Advisors, Inc. (“CedarPoint”), an SEC registered investment advisory firm with approximately \$180.0 million in assets under administration, on March 28, 2017.

#### **Our Principal Businesses**

**Traditional Community Banking.** Our traditional community banking business primarily consists of commercial and retail lending and deposit taking. We deliver a comprehensive range of banking products and services to individuals, businesses, municipalities and other entities within our market areas, which include Illinois (other than Chicago) and the St. Louis metropolitan area. As of December 31, 2018, we operated 69 banking offices in 48 communities.

Our lending strategy is to maintain a broadly diversified loan portfolio based on the type of customer (i.e., businesses versus individuals), type of loan product (e.g., owner occupied commercial real estate, commercial loans, agricultural loans, etc.), geographic location and industries in which our business customers are engaged (e.g.,

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manufacturing, retail, hospitality, etc.). We principally focus our commercial lending activities on loans that we originate from borrowers located in our market areas.

We market our lending products and services to qualified lending customers through branch offices and high touch personal service. We focus our business development and marketing strategy primarily on middle market businesses. Commercial lending products include owner occupied commercial real estate loans, commercial real estate investment loans, commercial loans (such as business term loans, equipment financing and lines of credit), real estate construction loans, multifamily loans and loans to purchase farmland and finance agricultural production.

Our primary products and services include the following:

*Commercial Loans.* Our commercial loan portfolio is comprised primarily of term loans to purchase capital equipment and lines of credit for working capital and operational purposes to small and midsized businesses. Although most loans are made on a secured basis, loans may be made on an unsecured basis where warranted by the overall financial condition of the borrower. Part of our commercial loan portfolio includes loans extended to finance agricultural equipment and production. These loans are typically short-term loans extended to farmers and other agricultural producers to purchase seed, fertilizer and equipment.

*Commercial Real Estate Loans.* We offer real estate loans for owner occupied and non-owner occupied commercial property. The real estate securing our existing commercial real estate loans includes a wide variety of property types, such as owner occupied offices, warehouses and production facilities, office buildings, hotels, mixed-use residential and commercial facilities, retail centers, multifamily properties and assisted living facilities. Our commercial real estate loan portfolio includes farmland loans. Farmland loans are generally made to a borrower actively involved in farming rather than to passive investors.

*Construction and Land Development Loans.* Our construction portfolio includes loans to small and midsized businesses to construct owner-user properties, loans to developers of commercial real estate investment properties and residential developments and, to a lesser extent, loans to individual clients for construction of single family homes in our market areas. These loans are typically disbursed as construction progresses and carry interest rates that vary with LIBOR.

*Residential Real Estate Loans.* We offer first and second mortgage loans to our individual customers primarily for the purchase of primary residences. We also offer home equity lines of credit (“HELOC”), consisting of loans secured by first or second mortgages on primarily owner-occupied primary residences.

*Consumer Installment Loans.* We provide consumer installment loans for the purchase of cars, boats and other recreational vehicles, as well as for the purchase of major appliances and other home improvement projects. Our major appliance and other home improvement lending is originated principally through national and regional retailers and other vendors of these products and services. We typically use a third party servicer for our national and regional home improvement loans.

*Commercial Equipment Leasing.* We originate and manage custom leasing and financing programs for commercial customers on a nationwide basis. The industries we service include manufacturing, construction and transportation and healthcare. The financings generated are typically retained and serviced by the Bank, and are generally in the \$50,000 to \$500,000 range, but can be larger in certain circumstances.

*Deposit Taking.* We offer traditional depository products, including checking, savings, money market and certificates of deposits, to individuals, businesses, municipalities and other entities throughout our market areas. We also offer sweep accounts to our business customers. Deposits at the Bank are insured by the Federal Deposit Insurance Corporation (the “FDIC”) up to statutory limits. We also offer sweep accounts that are guaranteed through repurchase agreements to our business and municipal customers. Our ability to gather deposits, particularly core deposits, is an important aspect of our business franchise.

*Residential Mortgage Origination.* Through the Bank, we also engage in the origination of residential mortgage loans. We sell the majority of these loans to the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) and various institutional purchasers, such as investment banks and other financial institutions.

**Wealth Management.** Our wealth management group operates under the name Midland Wealth Management and provides a comprehensive suite of trust and wealth management products and services, including financial and estate planning, trustee and custodial services, investment management, tax and insurance planning, business planning, corporate retirement plan consulting and administration and retail brokerage services through a nationally recognized third party broker dealer.

**FHA Origination and Servicing.** We conduct our FHA origination business through Love Funding. Love Funding originates commercial mortgage loans for multifamily and healthcare facilities under FHA insurance programs, and sells those loans into the secondary market through mortgage-backed securities guaranteed by the Government National Mortgage Association (“Ginnie Mae”). We generally retain the mortgage servicing rights on the underlying loans. Headquartered in Washington, D.C., Love Funding operates on a nationwide basis.

## **Competition**

We compete in a number of areas, including commercial and retail banking, residential mortgages, wealth management, commercial equipment leasing and financing and commercial FHA loan originations in the multifamily and healthcare sectors. These industries are highly competitive, and the Bank and its subsidiaries face strong direct competition for deposits, loans and leases, wealth management, FHA loan originations and other financial-related services. We compete with other community banks, thrifts and credit unions. Although some of these competitors are situated locally, others have statewide or regional presence. In addition, we compete with large banks and other financial intermediaries, such as consumer finance companies, brokerage firms, mortgage banking companies, business leasing and finance companies, insurance companies, FHA loan origination businesses, securities firms, mutual funds and certain government agencies as well as major retailers, all actively engaged in providing various types of loans and other financial services. Additionally, we face growing competition from so-called “online businesses” with few or no physical locations, including online banks, lenders and consumer and commercial lending platforms, as well as automated retirement and investment service providers. We believe that the range and quality of products that we offer, the knowledge of our personnel and our emphasis on building long-lasting relationships sets us apart from our competitors.

Our banking operations are largely concentrated in Illinois and the St. Louis metropolitan area. According to the FDIC Summary of Deposits, as of June 30, 2018, there were 11 banks operating within Effingham County, Illinois, where three of the Bank’s offices are located, including its principal office. As of the same date, the Bank ranked first based on total deposits of all banking offices in Effingham County, with approximately 33.1% of the total deposits. As of June 30, 2018, there were 12 banks operating within Lee County, Illinois, where two of the Bank’s offices are located. As of the same date, the Bank ranked first based on total deposits of all banking offices in Lee County, with approximately 24.9% of the total deposits. With the addition of Alpine on February 28, 2018, the Bank also ranked first based on total deposits of all banking offices in Winnebago County, where 23 banks are operating and 12 of the Bank’s offices are located, with approximately 15.6% of the total deposits as of June 30, 2018. With the addition of Centruie on June 9, 2017, the Bank ranked second based on total deposits of all banking offices in Kankakee County, where 16 banks are operating and seven of the Bank’s offices are located, with approximately 15.5% of the total deposits as of June 30, 2018. The Bank also has branches located in Bond, Boone, Bureau, Champaign, Dekalb, Fayette, Grundy, Kendall, La Salle, Livingston, Marion, Monroe, St. Clair, Stephenson, Whiteside and Will counties in Illinois. In the entire state of Illinois, as of June 30, 2018, there were 502 banks operating, and the Bank had approximately 0.45% of total deposits. The Bank also has branches and competes for deposits and loans in Franklin, Jefferson, St. Charles, and St. Louis counties in Missouri.

## **Employees**

As of December 31, 2018, we had approximately 1,100 employees. None of our employees are represented by any collective bargaining unit or are a party to a collective bargaining agreement. We believe that our relations with our employees are good.

## **Corporate Information**

Our principal executive offices are located at 1201 Network Centre Drive, Effingham, Illinois 62401, and our telephone number at that address is (217) 342-7321. Through our website at [www.midlandsb.com](http://www.midlandsb.com) under “Investors,” we make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission (the

## **Supervision and Regulation**

### ***General***

FDIC-insured institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, the Company’s growth and earnings performance may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Illinois Department of Financial and Professional Regulation (the “DFPR”), the Federal Reserve, the FDIC and the Consumer Financial Protection Bureau (“CFPB”). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board, securities laws administered by the SEC and state securities authorities, and anti-money laundering laws enforced by the Treasury have an impact on the Company’s business. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to the Company’s operations and results.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of FDIC-insured institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than shareholders. These laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of the Company’s business, the kinds and amounts of investments the Company and the Bank may make, reserve requirements, required capital levels relative to assets, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with the Company’s and the Bank’s insiders and affiliates and the Company’s payment of dividends. In reaction to the global financial crisis and particularly following the passage of the Dodd Frank Act, the Company experienced heightened regulatory requirements and scrutiny. Although the reforms primarily targeted systemically important financial service providers, their influence filtered down in varying degrees to community banks over time and caused the Company’s compliance and risk management processes, and the costs thereof, to increase. After the 2016 federal elections, momentum to decrease the regulatory burden on community banks gathered strength. In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Regulatory Relief Act”) was enacted to modify or remove certain financial reform rules and regulations. While the Regulatory Relief Act maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than \$10 billion, like the Company, and for large banks with assets of more than \$50 billion. Many of these changes are intended to result in meaningful regulatory relief for community banks and their holding companies, including new rules that may make the capital requirements less complex. For a discussion of capital requirements, see “—The Role of Capital.” It also eliminated questions about the applicability of certain Dodd-Frank Act reforms to community bank systems, including relieving the Bank of any requirement to engage in mandatory stress tests or comply with the Volcker Rule’s complicated prohibitions on proprietary trading and ownership of private funds. The Company believes these reforms are favorable to its operations, but the true impact remains difficult to predict until rulemaking is complete and the reforms are fully implemented.

The supervisory framework for U.S. banking organizations subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that are not publicly available and that can impact the conduct and growth of their business. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and its subsidiary bank, beginning with a discussion of the continuing regulatory emphasis on the Company’s capital levels. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

### ***The Role of Capital***

Regulatory capital represents the net assets of a banking organization available to absorb losses. Because of the

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risks attendant to their business, FDIC-insured institutions are generally required to hold more capital than other businesses, which directly affects the Company's earnings capabilities. While capital has historically been one of the key measures of the financial health of both bank holding companies and banks, its role became fundamentally more important in the wake of the global financial crisis, as the banking regulators recognized that the amount and quality of capital held by banks prior to the crisis was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, establish capital standards for banks and bank holding companies that are meaningfully more stringent than those in place previously.

*Minimum Required Capital Levels.* Banks have been required to hold minimum levels of capital based on guidelines established by the bank regulatory agencies since 1983. The minimums have been expressed in terms of ratios of "capital" divided by "total assets". As discussed below, bank capital measures have become more sophisticated over the years and have focused more on the quality of capital and the risk of assets. Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and have been able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for holding companies on a consolidated basis as stringent as those required for FDIC-insured institutions. A result of this change is that the proceeds of hybrid instruments, such as trust preferred securities, were excluded from capital over a phase-out period. However, if such securities were issued prior to May 19, 2010 by bank holding companies with less than \$15 billion of assets, they may be retained, subject to certain restrictions. Because the Company has assets of less than \$15 billion, the Company is able to maintain its trust preferred proceeds as capital but the Company has to comply with new capital mandates in other respects and will not be able to raise capital in the future through the issuance of trust preferred securities.

*The Basel International Capital Accords.* The risk-based capital guidelines for U.S. banks since 1989 were based upon the 1988 capital accord known as "Basel I" adopted by the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors that acts as the primary global standard-setter for prudential regulation, as implemented by the U.S. bank regulatory agencies on an interagency basis. The accord recognized that bank assets for the purpose of the capital ratio calculations needed to be assigned risk weights (the theory being that riskier assets should require more capital) and that off-balance sheet exposures needed to be factored in the calculations. Basel I had a very simple formula for assigning risk weights to bank assets from 0% to 100% based on four categories. In 2008, the banking agencies collaboratively began to phase-in capital standards based on a second capital accord, referred to as "Basel II," for large or "core" international banks (generally defined for U.S. purposes as having total assets of \$250 billion or more, or consolidated foreign exposures of \$10 billion or more) known as "advanced approaches" banks. The primary focus of Basel II was on the calculation of risk weights based on complex models developed by each advanced approaches bank. Because most banks were not subject to Basel II, the U.S. bank regulators worked to improve the risk sensitivity of Basel I standards without imposing the complexities of Basel II. This "standardized approach" increased the number of risk-weight categories and recognized risks well above the original 100% risk weight. It is institutionalized by the Dodd-Frank Act for all banking organizations, even for the advanced approaches banks, as a floor.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement on a strengthened set of capital requirements for banking organizations around the world, known as Basel III, to address deficiencies recognized in connection with the global financial crisis.

*The Basel III Rule.* In July 2013, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act (the "Basel III Rule"). In contrast to capital requirements historically, which were in the form of guidelines, Basel III was released in the form of enforceable regulations by each of the regulatory agencies. The Basel III Rule is applicable to all banking organizations that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies, other than "small bank holding companies" (generally holding companies with consolidated assets of less than \$3 billion that do not have securities registered with the SEC). Banking organizations became subject to the Basel III Rule on January 1, 2015 and all parts of it were fully phased-in as of January 1, 2019.

The Basel III Rule increased the required quantity and quality of capital and, for nearly every class of assets, it requires a more complex, detailed and calibrated assessment of risk and calculation of risk-weight amounts.



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Not only did the Basel III Rule increase most of the required minimum capital ratios in effect prior to January 1, 2015, but it introduced the concept of Common Equity Tier 1 Capital, which consists primarily of common stock, related surplus (net of Treasury stock), retained earnings, and Common Equity Tier 1 minority interests subject to certain regulatory adjustments. The Basel III Rule also changed the definition of capital by establishing more stringent criteria that instruments must meet to be considered Additional Tier 1 Capital (primarily non-cumulative perpetual preferred stock that meets certain requirements) and Tier 2 Capital (primarily other types of preferred stock and subordinated debt, subject to limitations). A number of instruments that qualified as Tier 1 Capital under Basel I do not qualify, or their qualifications changed. For example, noncumulative perpetual preferred stock, which qualified as simple Tier 1 Capital under Basel I, does not qualify as Common Equity Tier 1 Capital, but qualifies as Additional Tier 1 Capital. The Basel III Rule also constrained the inclusion of minority interests, mortgage-servicing assets, and deferred tax assets in capital and requires deductions from Common Equity Tier 1 Capital in the event that such assets exceed a certain percentage of a banking institution's Common Equity Tier 1 Capital.

The Basel III Rule required **minimum** capital ratios as of January 1, 2015, as follows:

- A ratio of minimum Common Equity Tier 1 Capital equal to 4.5% of risk-weighted assets;
- An increase in the minimum required amount of Tier 1 Capital from 4% to 6% of risk-weighted assets;
- A continuation of the minimum required amount of Total Capital (Tier 1 plus Tier 2) at 8% of risk-weighted assets; and
- A minimum leverage ratio of Tier 1 Capital to total quarterly average assets equal to 4% in all circumstances.

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain 2.5% in Common Equity Tier 1 Capital attributable to a capital conservation buffer (fully phased-in as of January 1, 2019). The purpose of the conservation buffer is to ensure that banking institutions maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the conservation buffer increases the minimum ratios depicted above to 7% for Common Equity Tier 1 Capital, 8.5% for Tier 1 Capital and 10.5% for Total Capital.

*Well-Capitalized Requirements.* The ratios described above are minimum standards in order for banking organizations to be considered "adequately capitalized." Bank regulatory agencies uniformly encourage banks to hold more capital and be "well-capitalized" and, to that end, federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is well-capitalized may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept, roll-over or renew brokered deposits. Higher capital levels could also be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (*i.e.*, Tier 1 Capital less all intangible assets), well above the minimum levels.

Under the capital regulations of the Federal Reserve, in order to be well-capitalized, a banking organization must maintain:

- A Common Equity Tier 1 Capital ratio to risk-weighted assets of 6.5% or more;
- A ratio of Tier 1 Capital to total risk-weighted assets of 8% or more (6% under Basel I);
- A ratio of Total Capital to total risk-weighted assets of 10% or more (the same as Basel I); and
- A leverage ratio of Tier 1 Capital to total adjusted average quarterly assets of 5% or greater.

It is possible under the Basel III Rule to be well-capitalized while remaining out of compliance with the capital conservation buffer discussed above.

As of December 31, 2018: (i) the Bank was not subject to a directive from the Federal Reserve to increase its

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capital; and (ii) the Bank was well-capitalized, as defined by Federal Reserve regulations. As of December 31, 2018, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Basel III Rule requirements to be well-capitalized.

*Prompt Corrective Action.* The concept of an institution being "well-capitalized" is part of a regulatory enforcement regime that provides the federal banking regulators with broad power to take "prompt corrective action" to resolve the problems of institutions based on the capital level of each particular institution. The extent of the regulators' powers depends on whether the institution in question is "adequately capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized," in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution's asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to sell itself; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate that the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

*The Potential for Community Bank Capital Simplification.* Community banks have long raised concerns with bank regulators about the regulatory burden, complexity, and costs associated with certain provisions of the Basel III Rule. In response, Congress provided a potential Basel III "off-ramp" for institutions, like the Company, with total consolidated assets of less than \$10 billion. Section 201 of the Regulatory Relief Act instructed the federal banking regulators to establish a single "Community Bank Leverage Ratio" ("CBLR") of between 8 and 10%. On November 21, 2018, the agencies proposed setting the CBLR at 9% of tangible equity to total assets for a qualifying bank to be well-capitalized. Under the proposal, a community banking organization would be eligible to elect the new framework if it has less than \$10 billion in total consolidated assets, limited amounts of certain assets and off-balance sheet exposures, and a CBLR greater than 9%. The electing institution would not be required to calculate the existing risk-based and leverage capital requirements of the Basel III Rule and would not need to risk weight its assets for purposes of capital calculations.

The Company is in the process of considering the CBLR proposal and will await the final regulation to determine whether it will elect the framework.

### ***Regulation and Supervision of the Company***

*General.* The Company, as the sole shareholder of the Bank, is a bank holding company. As a bank holding company, the Company is registered with, and is subject to regulation supervision and enforcement by, the Federal Reserve under the BHCA. The Company is legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is required to file with the Federal Reserve periodic reports of the Company's operations and such additional information regarding the Company and its subsidiaries as the Federal Reserve may require.

*Acquisitions, Activities and Financial Holding Company Election.* The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its FDIC-insured institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and well-managed in order to effect interstate mergers or acquisitions. For a discussion of the capital requirements, see "--The Role of Capital" above.

The BHCA generally prohibits the Company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of

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banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be “so closely related to banking ... as to be a proper incident thereto.” This authority permits the Company to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage services. The BHCA does not place territorial restrictions on the domestic activities of nonbank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature or incidental to any such financial activity or that the Federal Reserve determines by order to be complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of FDIC-insured institutions or the financial system generally. In 2006, the Company elected to operate as a financial holding company, which election affords the ability to respond more quickly to market developments and opportunities. In order to maintain its status as a financial holding company, the Company and the Bank must be well-capitalized, well-managed, and the Bank must have a least a satisfactory CRA rating. If the Federal Reserve determines that a financial holding company is not well-capitalized or well-managed, the Company has a period of time in which to achieve compliance, but during the period of noncompliance, the Federal Reserve may place any limitations on the Company it believes to be appropriate. Furthermore, if the Federal Reserve determines that a financial holding company’s subsidiary bank has not received a satisfactory CRA rating, that company will not be able to commence any new financial activities or acquire a company that engages in such activities.

*Change in Control.* Federal law also prohibits any person or company from acquiring “control” of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. “Control” is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances between 10% and 24.99% ownership.

*Capital Requirements.* Bank holding companies are required to maintain capital in accordance with Federal Reserve capital adequacy requirements. For a discussion of capital requirements, see “—The Role of Capital” above.

*Dividend Payments.* The Company’s ability to pay dividends to the Company’s shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As an Illinois corporation, the Company is subject to the limitations of the Illinois Business Corporations Act, as amended, which allows us to pay dividends unless, after such dividend, (i) the Company would not be able to pay its debts as they become due in the usual course of business or (ii) the Company’s total assets would be less than the sum of the Company’s total liabilities plus any amount that would be needed if it were to be dissolved at the time of the dividend payment, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to the rights of the shareholders receiving the distribution.

As a general matter, the Federal Reserve has indicated that the board of directors of a bank holding company should eliminate, defer or significantly reduce dividends to shareholders if: (i) the company’s net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company’s capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their nonbank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends have to maintain 2.5% in Common Equity Tier 1 Capital attributable to the capital conservation buffer. See “—The Role of Capital” above.

*Incentive Compensation.* There have been a number of developments in recent years focused on incentive compensation plans sponsored by bank holding companies and banks, reflecting recognition by the bank regulatory agencies and Congress that flawed incentive compensation practices in the financial industry were one of many factors

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contributing to the global financial crisis. Layered on top of that are the abuses in the headlines dealing with product cross-selling incentive plans. The result is interagency guidance on sound incentive compensation practices.

The interagency guidance recognized three core principles. Effective incentive plans should: (i) provide employees incentives that appropriately balance risk and reward; (ii) be compatible with effective controls and risk-management; and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. Much of the guidance addresses large banking organizations and, because of the size and complexity of their operations, the regulators expect those organizations to maintain systematic and formalized policies, procedures, and systems for ensuring that the incentive compensation arrangements for all executive and non-executive employees covered by this guidance are identified and reviewed, and appropriately balance risks and rewards. Smaller banking organizations like the Company that use incentive compensation arrangements are expected to be less extensive, formalized, and detailed than those of the larger banks.

*Monetary Policy.* The monetary policy of the Federal Reserve has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the tools available to the Federal Reserve to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on bank borrowings and changes in reserve requirements against bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

*Federal Securities Regulation.* The Company's common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Exchange Act. Consequently, the Company is subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

*Corporate Governance.* The Dodd-Frank Act addressed many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies. The Dodd Frank Act increased shareholder influence over boards of directors by requiring companies to give shareholders a nonbinding vote on executive compensation and so-called "golden parachute" payments, and authorizing the SEC to promulgate rules that would allow shareholders to nominate and solicit voters for their own candidates using a company's proxy materials. The legislation also directed the Federal Reserve to promulgate rules prohibiting excessive compensation paid to executives of bank holding companies, regardless of whether such companies are publicly traded.

### ***Regulation and Supervision of the Bank***

*General.* The Bank is an Illinois-chartered bank. The deposit accounts of the Bank are insured by the FDIC's Deposit Insurance Fund ("DIF") to the maximum extent provided under federal law and FDIC regulations, currently \$250,000 per insured depositor category. As an Illinois-chartered FDIC-insured bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the DFPR, the chartering authority for Illinois banks, and, as a member bank, the Federal Reserve.

*Deposit Insurance.* As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured institutions pay insurance premiums at rates based on their risk classification. For institutions like the Bank that are not considered large and highly complex banking organizations, assessments are now based on examination ratings and financial ratios. The total base assessment rates currently range from 1.5 basis points to 30 basis points. At least semi-annually, the FDIC updates its loss and income projections for the DIF and, if needed, increases or decreases the assessment rates, following notice and comment on proposed rulemaking. The assessment base against which an FDIC-insured institution's deposit insurance premiums paid to the DIF has been calculated since effectiveness of the Dodd-Frank Act based on its average consolidated total assets less its average tangible equity. This method shifted the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits.

The reserve ratio is the FDIC insurance fund balance divided by estimated insured deposits. The Dodd-Frank Act altered the minimum reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to FDIC-insured institutions when the reserve ratio exceeds certain thresholds. The reserve ratio reached 1.36% as of September 30, 2018 (most recent available), exceeding the statutory required minimum reserve ratio of 1.35%. The FDIC will provide assessment credits to insured depository institutions, like the Bank, with total consolidated assets of less than \$10 billion for the portion of their regular assessments that contribute to growth in the reserve ratio between 1.15% and 1.35%. The

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FDIC will apply the credits each quarter that the reserve ratio is at least 1.38% to offset the regular deposit insurance assessments of institutions with credits.

*FICO Assessments.* In addition to paying basic deposit insurance assessments, FDIC-insured institutions must pay FICO assessments. FICO is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Competitive Equality Banking Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year noncallable bonds of approximately \$8.1 billion that mature in 2018 through 2019. FICO's authority to issue bonds ended on December 12, 1991. Since 1996, federal legislation has required that all FDIC-insured institutions pay assessments to cover interest payments on FICO's outstanding obligations. The FICO assessment rate is adjusted quarterly and for the fourth quarter of 2018 was 32 cents per \$100 dollars of assessable deposits.

*Supervisory Assessments.* All Illinois-chartered banks are required to pay supervisory assessments to the DFPR to fund the operations of that agency. The amount of the assessment is calculated on the basis of the Bank's total assets. During the year ended December 31, 2018, the Bank paid supervisory assessments to the DFPR totaling approximately \$305,000.

*Capital Requirements.* Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see "—The Role of Capital" above.

*Liquidity Requirements.* Liquidity is a measure of the ability and ease with which bank assets may be converted to cash. Liquid assets are those that can be converted to cash quickly if needed to meet financial obligations. To remain viable, FDIC-insured institutions must have enough liquid assets to meet their near-term obligations, such as withdrawals by depositors. Because the global financial crisis was in part a liquidity crisis, Basel III also includes a liquidity framework that requires FDIC-insured institutions to measure their liquidity against specific liquidity tests. One test, referred to as the LCR, is designed to ensure that the banking entity has an adequate stock of unencumbered high-quality liquid assets that can be converted easily and immediately in private markets into cash to meet liquidity needs for a 30-calendar day liquidity stress scenario. The other test, known as the NSFR, is designed to promote more medium- and long-term funding of the assets and activities of FDIC-insured institutions over a one-year horizon. These tests provide an incentive for banks and holding companies to increase their holdings in Treasury securities and other sovereign debt as a component of assets, increase the use of long-term debt as a funding source and rely on stable funding like core deposits (in lieu of brokered deposits).

In addition to liquidity guidelines already in place, the federal bank regulatory agencies implemented the Basel III LCR in September 2014, which requires large financial firms to hold levels of liquid assets sufficient to protect against constraints on their funding during times of financial turmoil, and in 2016 proposed implementation of the NSFR. While these rules do not, and will not, apply to the Bank, it continues to review its liquidity risk management policies in light of these developments.

*Dividend Payments.* The primary source of funds for the Company is dividends from the Bank. Under Illinois banking law, Illinois-chartered banks generally may pay dividends only out of undivided profits. The DFPR may restrict the declaration or payment of a dividend by an Illinois-chartered bank, such as the Bank. The payment of dividends by any FDIC-insured institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a FDIC-insured institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its capital requirements under applicable guidelines as of December 31, 2018. Notwithstanding the availability of funds for dividends, however, the Federal Reserve and the DFPR may prohibit the payment of dividends by the Bank if either or both determine such payment would constitute an unsafe or unsound practice. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends have to maintain 2.5% in Common Equity Tier 1 Capital attributable to the capital conservation buffer. See "—The Role of Capital" above.

*State Bank Investments and Activities.* The Bank is permitted to make investments and engage in activities directly or through subsidiaries as authorized by Illinois law, as applicable. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum

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regulatory capital requirements and the FDIC determines that the activity would not pose a significant risk to the DIF. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank.

*Insider Transactions.* The Bank is subject to certain restrictions imposed by federal law on “covered transactions” between the Bank and its “affiliates.” The Company is an affiliate of the Bank for purposes of these restrictions, and covered transactions subject to the restrictions include extensions of credit to the Company, investments in the stock or other securities of the Company and the acceptance of the stock or other securities of the Company as collateral for loans made by the Bank. The Dodd-Frank Act enhanced the requirements for certain transactions with affiliates, including an expansion of the definition of “covered transactions” and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company and its subsidiaries, to principal shareholders of the Company and to “related interests” of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank, or a principal shareholder of the Company, may obtain credit from banks with which the Bank maintains a correspondent relationship.

*Safety and Soundness Standards/Risk Management.* The federal banking agencies have adopted operational and managerial standards to promote the safety and soundness of FDIC-insured institutions. The standards apply to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness standards prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. While regulatory standards do not have the force of law, if an institution operates in an unsafe and unsound manner, the FDIC-insured institution’s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an FDIC-insured institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator’s order is cured, the regulator may restrict the FDIC-insured institution’s rate of growth, require the FDIC-insured institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with safety and soundness may also constitute grounds for other enforcement action by the federal bank regulatory agencies, including cease and desist orders and civil money penalty assessments.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the FDIC-insured institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk. In particular, recent regulatory pronouncements have focused on operational risk, which arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses. New products and services, third-party risk and cybersecurity are critical sources of operational risk that FDIC-insured institutions are expected to address in the current environment. The Bank is expected to have active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls.

*Branching Authority.* Illinois banks, such as the Bank, have the authority under Illinois law to establish branches anywhere in the State of Illinois, subject to receipt of all required regulatory approvals. The establishment of new interstate branches has historically been permitted only in those states the laws of which expressly authorize such expansion. The Dodd-Frank Act permits well-capitalized and well-managed banks to establish new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) without impediments. Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger.

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*Transaction Account Reserves.* Federal Reserve regulations require FDIC-insured institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts). For 2019, the first \$16.3 million of otherwise reservable balances are exempt from reserves and have a zero percent reserve requirement; for transaction accounts aggregating between \$16.3 million to \$124.2 million, the reserve requirement is 3% of those transaction account balances; and for net transaction accounts in excess of \$124.2 million, the reserve requirement is 10% of the aggregate amount of total transaction account balances in excess of \$124.2 million. These reserve requirements are subject to annual adjustment by the Federal Reserve.

*Community Reinvestment Act Requirements.* The Community Reinvestment Act requires the Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods. Federal regulators regularly assess the Bank's record of meeting the credit needs of its communities. Applications for additional acquisitions would be affected by the evaluation of the Bank's effectiveness in meeting its Community Reinvestment Act requirements.

*Anti-Money Laundering.* The USA Patriot Act is designed to deny terrorists and criminals the ability to obtain access to the U.S. financial system and has significant implications for FDIC-insured institutions, brokers, dealers and other businesses involved in the transfer of money. The USA Patriot Act mandates financial services companies to have policies and procedures with respect to measures designed to address any or all of the following matters: (i) customer identification programs; (ii) money laundering; (iii) terrorist financing; (iv) identifying and reporting suspicious activities and currency transactions; (v) currency crimes; and (vi) cooperation between FDIC-insured institutions and law enforcement authorities.

*Privacy and Cybersecurity.* The Bank is subject to many U.S. federal and state laws and regulations governing requirements for maintaining policies and procedures to protect non-public confidential information of their customers. These laws require the Bank to periodically disclose their privacy policies and practices relating to sharing such information and permit consumers to opt out of their ability to share information with unaffiliated third parties under certain circumstances. They also impact the Bank's ability to share certain information with affiliates and non-affiliates for marketing and/or non-marketing purposes, or to contact customers with marketing offers. In addition, the Bank is required to implement a comprehensive information security program that includes administrative, technical, and physical safeguards to ensure the security and confidentiality of customer records and information. These security and privacy policies and procedures, for the protection of personal and confidential information, are in effect across all businesses and geographic locations.

*Concentrations in Commercial Real Estate.* Concentration risk exists when FDIC-insured institutions deploy too many assets to any one industry or segment. A concentration in commercial real estate is one example of regulatory concern. The interagency Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices guidance ("CRE Guidance") provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. On December 18, 2015, the federal banking agencies issued a statement to reinforce prudent risk-management practices related to CRE lending, having observed substantial growth in many CRE asset and lending markets, increased competitive pressures, rising CRE concentrations in banks, and an easing of CRE underwriting standards. The federal bank agencies reminded FDIC-insured institutions to maintain underwriting discipline and exercise prudent risk-management practices to identify, measure, monitor, and manage the risks arising from CRE lending. In addition, FDIC-insured institutions must maintain capital commensurate with the level and nature of their CRE concentration risk.

As of December 31, 2018, the Bank did not exceed these guidelines.

*Consumer Financial Services.* The historical structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination

and enforcement authority over providers with more than \$10 billion in assets. FDIC-insured institutions with \$10 billion or less in assets, like the Bank, continue to be examined by their applicable bank regulators.

Because abuses in connection with residential mortgages were a significant factor contributing to the financial crisis, many new rules issued by the CFPB and required by the Dodd-Frank Act addressed mortgage and mortgage-related products, their underwriting, origination, servicing and sales. The Dodd-Frank Act significantly expanded underwriting requirements applicable to loans secured by 1-4 family residential real property and augmented federal law combating predatory lending practices. In addition to numerous disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages." The Regulatory Relief Act provided relief in connection with mortgages for banks with assets of less than \$10 billion, and, as a result, mortgages the Bank makes are now considered to be qualified mortgages if they are held in portfolio for the life of the loan.

The Company does not expect the CFPB's rules to have a significant impact on its operations, except for higher compliance costs.

### ***Regulation of Affiliates***

The Company operates two affiliates that are regulated by functional financial regulatory agencies. Midland Risk Management Company, Inc. is a captive insurance company organized under the laws of the state of Nevada and subject to regulation, supervision and enforcement by the state Department of Insurance. Midland Financial Advisors, Inc. is a registered investment advisor. The SEC has supervisory, examination and enforcement authority over its operations. The SEC's focus is primarily for the protection of investors under the federal securities laws.

## **Item 1A – Risk Factors**

The material risks that management believes affect the Company are described below. You should carefully consider the risks, together with all of the information included herein. The risks described below are not the only risks the Company faces. Additional risks not presently known or that the Company believes are immaterial also may have a material adverse effect on the Company's results of operations and financial condition.

### **Risks Related to Our Business**

***A decline in general business and economic conditions and any regulatory responses to such conditions could have a material adverse effect on our business, financial position, results of operations and growth prospects.***

Our business and operations are sensitive to business and economic conditions in the United States, generally, and particularly the state of Illinois and the St. Louis metropolitan area. If the national, regional and local economies experience worsening economic conditions, including high levels of unemployment, our growth and profitability could be constrained. Weak economic conditions are characterized by, among other indicators, deflation, elevated levels of unemployment, fluctuations in debt and equity capital markets, increased delinquencies on mortgage, commercial and consumer loans, residential and commercial real estate price declines, lower home sales and commercial activity and fluctuations in the commercial FHA financing sector. All of these factors are generally detrimental to our business. Our business is significantly affected by monetary and other regulatory policies of the U.S. federal government, its agencies and government-sponsored entities. Changes in any of these policies are influenced by macroeconomic conditions and other factors that are beyond our control, are difficult to predict and could have a material adverse effect on our business, financial position, results of operations and growth prospects.

***If we do not effectively manage our credit risk, we may experience increased levels of nonperforming loans, charge-offs and delinquencies, which could require increases in our provision for loan losses.***

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of nonpayment, risks resulting from uncertainties as to the future value of collateral and cash flows available to service debt and risks resulting from changes in economic and market conditions. We cannot guarantee that our credit underwriting and monitoring procedures will reduce these credit risks, and they cannot be expected to completely eliminate our credit risks. If the overall economic climate in the United States, generally, or our market areas, specifically, declines, our borrowers may experience difficulties in repaying their loans, and the level of nonperforming



loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses, which would cause our net income, return on equity and capital to decrease.

***Our allowance for loan losses may prove to be insufficient to absorb potential losses in our loan portfolio.***

We maintain our allowance for loan losses at a level that management considers adequate to absorb probable loan losses based on an analysis of our portfolio and market environment. The allowance for loan losses represents our estimate of probable losses in the portfolio at each balance sheet date and is based upon relevant information available to us. The actual amount of loan losses is affected by changes in economic, operating and other conditions within our markets, which may be beyond our control, and such losses may exceed current estimates.

As of December 31, 2018, our allowance for loan losses as a percentage of total loans was 0.51% and as a percentage of total nonperforming loans was 48.7%. Although management believed, as of such date, that the allowance for loan losses was adequate to absorb losses on any existing loans that may become uncollectible, we may be required to take additional provisions for loan losses in the future to further supplement the allowance for loan losses, either due to management's decision to do so or because our banking regulators require us to do so. Our bank regulatory agencies will periodically review our allowance for loan losses and the value attributed to nonaccrual loans or to real estate acquired through foreclosure and may require us to adjust our determination of the value for these items. These adjustments may adversely affect our business, financial condition and results of operations.

***Because a significant portion of our loan portfolio is comprised of real estate loans, negative changes in the economy affecting real estate values and liquidity could impair the value of collateral securing our real estate loans and result in loan and other losses.***

At December 31, 2018, approximately 59.2% of our loan portfolio was comprised of loans with real estate as a primary or secondary component of collateral. As a result, adverse developments affecting real estate values in our market areas could increase the credit risk associated with our real estate loan portfolio. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the area in which the real estate is located. Adverse changes affecting real estate values and the liquidity of real estate in one or more of our markets could increase the credit risk associated with our loan portfolio, significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses, which could result in losses that would adversely affect profitability. Such declines and losses would have a material adverse impact on our business, results of operations and growth prospects. In addition, if hazardous or toxic substances are found on properties pledged as collateral, the value of the real estate could be impaired. If we foreclose on and take title to such properties, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit our ability to use or sell the affected property.

***Many of our loans are to commercial borrowers, which have a higher degree of risk than other types of loans.***

Commercial loans represented 64.8% of our total loan portfolio at December 31, 2018. Commercial loans are often larger and involve greater risks than other types of lending. Because payments on such loans often depend on the successful operation or development of the property or business involved, repayment of such loans is often more sensitive than other types of loans to adverse conditions in the real estate market or the general business climate and economy. Accordingly, a downturn in the real estate market and a challenging business and economic environment may increase our risk related to commercial loans, particularly commercial real estate loans. Unlike residential mortgage loans, which generally are made on the basis of the borrowers' ability to make repayment from their employment and other income and which are secured by real property, the value of which tends to be more easily ascertainable, commercial loans typically are made on the basis of the borrowers' ability to make repayment from the cash flow of the commercial venture. Our operating commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the collateral underlying the loans. Most often, this collateral consists of accounts receivable, inventory and equipment. Inventory and equipment may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. If the cash flow from business operations is reduced, the borrower's ability to repay the loan may be impaired. Due to the larger average size of each commercial loan as compared with other loans such as residential loans, as well as collateral that is generally less readily-marketable, losses incurred on a small number of commercial loans could have a material adverse impact on our financial condition and results of operations.

***The small to midsized businesses that we lend to may have fewer resources to weather adverse business developments, which may impair a borrower's ability to repay a loan, and such impairment could adversely affect our results of operations and financial condition.***

We target our business development and marketing strategy primarily to serve the banking and financial services needs of small to midsized businesses. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities, frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small or midsized business often depends on the management talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could have a material adverse impact on the business and its ability to repay its loan. If general economic conditions negatively impact the markets in which we operate and small to midsized businesses are adversely affected or our borrowers are otherwise affected by adverse business developments, our business, financial condition and results of operations may be adversely affected.

***Real estate construction loans are based upon estimates of costs and values associated with the complete project. These estimates may be inaccurate, and we may be exposed to significant losses on loans for these projects.***

Real estate construction loans comprised approximately 5.6% of our total loan portfolio as of December 31, 2018, and such lending involves additional risks because funds are advanced upon the security of the project, which is of uncertain value prior to its completion, and costs may exceed realizable values in declining real estate markets. Because of the uncertainties inherent in estimating construction costs and the realizable market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated or market values or rental rates decline, we may have inadequate security for the repayment of the loan upon completion of construction of the project. If we are forced to foreclose on a project prior to or at completion due to a default, we may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time while we attempt to dispose of it.

***The occurrence of fraudulent activity, breaches or failures of our information security controls or cybersecurity-related incidents could have a material adverse effect on our business, financial condition, results of operations and growth prospects.***

As a bank, we are susceptible to fraudulent activity, information security breaches and cybersecurity-related incidents that may be committed against us or our clients, which may result in financial losses or increased costs to us or our clients, disclosure or misuse of our information or our client information, misappropriation of assets, privacy breaches against our clients, litigation or damage to our reputation. Such fraudulent activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering and other dishonest acts. Information security breaches and cybersecurity-related incidents may include fraudulent or unauthorized access to systems used by us or our clients, denial or degradation of service attacks and malware or other cyber-attacks.

In recent periods, there continues to be a rise in electronic fraudulent activity, security breaches and cyber-attacks within the financial services industry, especially in the commercial banking sector due to cyber criminals targeting commercial bank accounts. Moreover, in recent periods, several large corporations, including financial institutions and retail companies, have suffered major data breaches, in some cases exposing not only confidential and proprietary corporate information, but also sensitive financial and other personal information of their customers and employees and subjecting them to potential fraudulent activity. Some of our clients may have been affected by these breaches, which could increase their risks of identity theft and other fraudulent activity that could involve their accounts with us.

Information pertaining to us and our clients is maintained, and transactions are executed, on networks and systems maintained by us and certain third party partners, such as our online banking, mobile banking or accounting systems. The secure maintenance and transmission of confidential information, as well as execution of transactions over these systems, are essential to protect us and our clients against fraud and security breaches and to maintain the

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confidence of our clients. Breaches of information security also may occur through intentional or unintentional acts by those having access to our systems or the confidential information of our clients, including employees. In addition, increases in criminal activity levels and sophistication, advances in computer capabilities, new discoveries, vulnerabilities in third party technologies (including browsers and operating systems) or other developments could result in a compromise or breach of the technology, processes and controls that we use to prevent fraudulent transactions and to protect data about us, our clients and underlying transactions, as well as the technology used by our clients to access our systems. Our third party partners' inability to anticipate, or failure to adequately mitigate, breaches of security could result in a number of negative events, including losses to us or our clients, loss of business or clients, damage to our reputation, the incurrence of additional expenses, disruption to our business, additional regulatory scrutiny or penalties or our exposure to civil litigation and possible financial liability, any of which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

### ***We depend on information technology and telecommunications systems of third parties, and any systems failures, interruptions or data breaches involving these systems could adversely affect our operations and financial condition.***

Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems, third party servicers, accounting systems, mobile and online banking platforms and financial intermediaries. We outsource to third parties many of our major systems, such as data processing and mobile and online banking. The failure of these systems, or the termination of a third party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third party systems, we could experience service denials if demand for such services exceeds capacity or such third party systems fail or experience interruptions. A system failure or service denial could result in a deterioration of our ability to process loans or gather deposits and provide customer service, compromise our ability to operate effectively, result in potential noncompliance with applicable laws or regulations, damage our reputation, result in a loss of customer business or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on business, financial condition, results of operations and growth prospects. In addition, failures of third parties to comply with applicable laws and regulations, or fraud or misconduct on the part of employees of any of these third parties, could disrupt our operations or adversely affect our reputation.

It may be difficult for us to replace some of our third party vendors, particularly vendors providing our core banking and information services, in a timely manner if they are unwilling or unable to provide us with these services in the future for any reason and even if we are able to replace them, it may be at higher cost or result in the loss of customers. Any such events could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Our operations rely heavily on the secure processing, storage and transmission of information and the monitoring of a large number of transactions on a minute-by-minute basis, and even a short interruption in service could have significant consequences. We also interact with and rely on retailers, for whom we process transactions, as well as financial counterparties and regulators. Each of these third parties may be targets of the same types of fraudulent activity, computer break-ins and other cyber security breaches described above, and the cyber security measures that they maintain to mitigate the risk of such activity may be different than our own and may be inadequate.

As a result of financial entities and technology systems becoming more interdependent and complex, a cyber incident, information breach or loss, or technology failure that compromises the systems or data of one or more financial entities could have a material impact on counterparties or other market participants, including ourselves. As a result of the foregoing, our ability to conduct business may be adversely affected by any significant disruptions to us or to third parties with whom we interact.

### ***We are subject to certain operational risks, including, but not limited to, customer or employee fraud and data processing system failures and errors.***

Employee errors and employee and customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence.

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We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. If our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

***Our strategy of pursuing growth via acquisitions exposes us to financial, execution and operational risks that could have a material adverse effect on our business, financial position, results of operations and growth prospects.***

Our acquisition activities could require us to use a substantial amount of cash, other liquid assets and/or incur debt. There are risks associated with an acquisition strategy, including the following:

- We may incur time and expense associated with identifying and evaluating potential acquisitions and negotiating potential transactions, resulting in management's attention being diverted from the operation of our existing business.
- We are exposed to potential asset and credit quality risks and unknown or contingent liabilities of the banks or businesses we acquire. If these issues or liabilities exceed our estimates, our earnings, capital and financial condition may be materially and adversely affected.
- The acquisition of other entities generally requires integration of systems, procedures and personnel of the acquired entity. This integration process is complicated and time consuming and can also be disruptive to the customers and employees of the acquired business and our business. If the integration process is not conducted successfully, we may not realize the anticipated economic benefits of acquisitions within the expected time frame, or ever, and we may lose customers or employees of the acquired business. We may also experience greater than anticipated customer losses even if the integration process is successful.
- To finance an acquisition, we may borrow funds or pursue other forms of financing, such as issuing voting and/or non-voting common stock or preferred stock, which may have high dividend rights or may be highly dilutive to holders of our common stock, thereby increasing our leverage and diminishing our liquidity.
- We may be unsuccessful in realizing the anticipated benefits from acquisitions. For example, we may not be successful in realizing anticipated cost savings. We also may not be successful in preventing disruptions in service to existing customer relationships of the acquired institution, which could lead to a loss in revenues.

In addition to the foregoing, we may face additional risks in acquisitions to the extent we acquire new lines of business or new products, or enter new geographic areas, in which we have little or no current experience, especially if we lose key employees of the acquired operations. We cannot assure you that we will be successful in overcoming these risks or any other problems encountered in connection with acquisitions. Our inability to overcome risks associated with acquisitions could have an adverse effect on our ability to successfully implement our acquisition growth strategy and grow our business and profitability.

***If the goodwill that we recorded in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on our financial condition and results of operations.***

Goodwill represents the amount by which the cost of an acquisition exceeded the fair value of net assets we acquired in connection with the purchase. We review goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate that the carrying value of the asset might be impaired.

We determine impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in our results of operations in the periods in which they become known. There can be no assurance that our future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on our financial condition and results of operations.

***We may not be able to continue growing our business, particularly if we cannot make acquisitions or increase loans through organic loan growth, either because of an inability to find suitable acquisition candidates, constrained capital resources or otherwise.***

While we intend to continue to grow our business through strategic acquisitions coupled with organic loan growth, because certain of our market areas are comprised of mature, rural communities with limited population growth, we anticipate that much of our future growth will be dependent on our ability to successfully implement our acquisition growth strategy. A risk exists, however, that we will not be able to identify suitable additional candidates for acquisitions. In addition, even if suitable targets are identified, we expect to compete for such businesses with other potential bidders, many of which may have greater financial resources than we have, which may adversely affect our ability to make acquisitions at attractive prices. Furthermore, many acquisitions we may wish to pursue would be subject to approvals by bank regulatory authorities, and we cannot predict whether any targeted acquisitions will receive the required regulatory approvals. In light of the foregoing, our ability to continue to grow successfully will depend to a significant extent on our capital resources. It also will depend, in part, upon our ability to attract deposits and to identify favorable loan and investment opportunities and on whether we can continue to fund growth while maintaining cost controls and asset quality, as well on other factors beyond our control, such as national, regional and local economic conditions and interest rate trends.

Also, as our acquired loan portfolio, which produces higher yields than our originated loans due to loan discount accretion, is paid down, we expect downward pressure on our income to the extent that the run-off is not replaced with other high-yielding loans. If we are unable to replace loans in our existing portfolio with comparable high-yielding loans or a larger volume of loans, our results of operations could be adversely affected. We could also be materially and adversely affected if we choose to pursue riskier higher-yielding loans that fail to perform.

***The accounting for loans acquired in connection with our acquisitions is based on numerous subjective determinations that may prove to be inaccurate and have a negative impact on our results of operations.***

Loans acquired in connection with our acquisitions have been recorded at estimated fair value on their acquisition date without a carryover of the related allowance for loan losses. In general, the determination of estimated fair value of acquired loans requires management to make subjective determinations regarding discount rate, estimates of losses on defaults, market conditions and other factors that are highly subjective in nature. A risk exists that our estimate of the fair value of acquired loans will prove to be inaccurate and that we ultimately will not recover the amount at which we recorded such loans on our balance sheet, which would require us to recognize losses.

Loans acquired in connection with acquisitions that have evidence of credit deterioration since origination and for which it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments are accounted for under Accounting Standards Codification (“ASC”) Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. These credit-impaired loans, like non-credit-impaired loans acquired in connection with our acquisitions, have been recorded at estimated fair value on their acquisition date, based on subjective determinations regarding risk ratings, expected future cash flows and fair value of the underlying collateral, without a carryover of the related allowance for loan losses. We evaluate these loans quarterly to assess expected cash flows. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable to accretable with a positive impact on interest income. Because the accounting for these loans is based on subjective measures that can change frequently, we may experience fluctuations in our net interest income and provisions for loan losses attributable to these loans. These fluctuations could negatively impact our results of operations.

***We are highly dependent on our management team, and the loss of our senior executive officers or other key employees could harm our ability to implement our strategic plan, impair our relationships with customers and adversely affect our business, results of operations and growth prospects.***

Our success is dependent, to a large degree, upon the continued service and skills of our existing executive management team, particularly Mr. Jeffrey G. Ludwig, our President and Chief Executive Officer, and Mr. Stephen A. Erickson, our Chief Financial Officer.

Our business and growth strategies are built primarily upon our ability to retain employees with experience and business relationships within their respective market areas. The loss of Mr. Ludwig, Mr. Erickson or any of our other key personnel could have an adverse impact on our business and growth because of their skills, years of industry experience,

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knowledge of our market areas and the difficulty of finding qualified replacement personnel, particularly in light of the fact that we are headquartered outside of a major metropolitan area. In addition, although we have non-competition agreements with each of our seven executive officers and with several others of our senior personnel, we do not have any such agreements with other employees who are important to our business, and in any event the enforceability of non-competition agreements varies across the states in which we do business. While our mortgage originators, loan officers and wealth management professionals are generally subject to non-solicitation provisions as part of their employment, our ability to enforce such agreements may not fully mitigate the injury to our business from the breach of such agreements, as such employees could leave us and immediately begin soliciting our customers. The departure of any of our personnel who are not subject to enforceable non-competition agreements could have a material adverse impact on our business, results of operations and growth prospects.

### ***Fluctuations in interest rates may reduce net interest income and otherwise negatively impact our financial condition and results of operations.***

Shifts in short-term interest rates may reduce net interest income, which is the principal component of our earnings. Net interest income is the difference between the amounts received by us on our interest-earning assets and the interest paid by us on our interest-bearing liabilities. When interest rates rise, the rate of interest we pay on our liabilities, such as deposits, rises more quickly than the rate of interest that we receive on our interest-bearing assets, such as loans, which may cause our profits to decrease. The impact on earnings is more adverse when the slope of the yield curve flattens, that is, when short-term interest rates increase more than long-term interest rates or when long-term interest rates decrease more than short-term interest rates.

Interest rate increases often result in larger payment requirements for our borrowers, which increases the potential for default. At the same time, the marketability of the underlying property may be adversely affected by any reduced demand resulting from higher interest rates. In a declining interest rate environment, there may be an increase in prepayments on loans as borrowers refinance their mortgages and other indebtedness at lower rates.

Changes in interest rates also can affect the value of loans, securities and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in nonperforming assets and a reduction of income recognized, which could have a material adverse effect on our results of operations and cash flows. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income. Subsequently, we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of nonperforming assets would have an adverse impact on net interest income.

If short-term interest rates remain at low levels for a prolonged period, and assuming longer term interest rates fall, we could experience net interest margin compression as our interest earning assets would continue to reprice downward while our interest-bearing liability rates could fail to decline in tandem. This would have a material adverse effect on our net interest income and our results of operations.

### ***Liquidity risks could affect operations and jeopardize our business, financial condition, and results of operations.***

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and/or investment securities and from other sources could have a substantial negative effect on our liquidity. Our most important source of funds consists of our customer deposits, including escrow deposits held in connection with our commercial mortgage servicing business. Such deposit balances can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff, or, in connection with our commercial mortgage servicing business, third parties for whom we provide servicing choose to terminate that relationship with us. If customers move money out of bank deposits and into other investments, we could lose a relatively low cost source of funds, which would require us to seek wholesale funding alternatives in order to continue to grow, thereby increasing our funding costs and reducing our net interest income and net income.

Our access to funding sources in amounts adequate to finance or capitalize our activities or on terms that are acceptable to us could be impaired by factors that affect us directly or the financial services industry or economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the financial services industry.

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Any decline in available funding could adversely impact our ability to continue to implement our strategic plan, including originate loans, invest in securities, meet our expenses, pay dividends to our shareholders or to fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, financial condition and results of operations.

***We may need to raise additional capital in the future, and if we fail to maintain sufficient capital, whether due to losses, an inability to raise additional capital or otherwise, our financial condition, liquidity and results of operations, as well as our ability to maintain regulatory compliance, would be adversely affected.***

We face significant capital and other regulatory requirements as a financial institution. The Company, on a consolidated basis, and the Bank, on a stand-alone basis, must meet certain regulatory capital requirements and maintain sufficient liquidity. Importantly, regulatory capital requirements could increase from current levels, which could require us to raise additional capital or contract our operations. Our ability to raise additional capital depends on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Accordingly, we cannot assure you that we will be able to raise additional capital if needed or on terms acceptable to us. If we fail to maintain capital to meet regulatory requirements, our financial condition, liquidity and results of operations would be materially and adversely affected.

***Decreased residential and commercial mortgage origination, volume and pricing decisions of competitors, and changes in interest rates, may adversely affect our profitability.***

We currently operate a residential and commercial mortgage origination and servicing business. Changes in interest rates and pricing decisions by our loan competitors may adversely affect demand for our mortgage loan products, the revenue realized on the sale of loans, revenues received from servicing such loans and the valuation of our mortgage servicing rights. New regulations, increased regulatory reviews, and/or changes in the structure of the secondary mortgage markets which we would utilize to sell mortgage loans may be introduced and may increase costs and make it more difficult to operate a residential and commercial mortgage origination and servicing business.

***We could recognize losses on securities held in our securities portfolio, particularly if interest rates increase or economic and market conditions deteriorate.***

Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. For example, fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise. Additional factors include, but are not limited to, rating agency downgrades of the securities or our own analysis of the value of the security, defaults by the issuer or individual mortgagors with respect to the underlying securities, and continued instability in the credit markets. Any of the foregoing factors could cause an other-than-temporary impairment in future periods and result in realized losses. The process for determining whether impairment is other-than-temporary usually requires difficult, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Because of changing economic and market conditions affecting interest rates, the financial condition of issuers of the securities and the performance of the underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our financial condition and results of operations.

***Downgrades in the credit rating of one or more insurers that provide credit enhancement for our state and municipal securities portfolio may have an adverse impact on the market for and valuation of these types of securities.***

We invest in tax-exempt state and local municipal securities, some of which are insured by monoline insurers. Even though management generally purchases municipal securities on the overall credit strength of the issuer, the reduction in the credit rating of an insurer may negatively impact the market for and valuation of our investment securities. Such downgrade could adversely affect our liquidity, financial condition and results of operations.

***Our mortgage banking profitability could significantly decline if we are not able to originate and resell a high volume of mortgage loans.***

Mortgage production, especially refinancing activity, declines in rising interest rate environments, and in a rising interest rate environment, there can be no assurance that our mortgage production will continue at current levels. Because we sell a substantial portion of the mortgage loans we originate, the profitability of our mortgage banking business also depends in large part on our ability to aggregate a high volume of loans and sell them in the secondary

market at a gain. Thus, in addition to our dependence on the interest rate environment, we are dependent upon (i) the existence of an active secondary market and (ii) our ability to profitably sell loans or securities into that market. If our level of mortgage production declines, the profitability will depend upon our ability to reduce our costs commensurate with the reduction of revenue from our mortgage operations.

Our ability to originate and sell mortgage loans readily is dependent upon the availability of an active secondary market for single-family mortgage loans, which in turn depends in part upon the continuation of programs currently offered by government-sponsored entities (“GSEs”) and other institutional and non-institutional investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. Because the largest participants in the secondary market are Fannie Mae and Freddie Mac, GSEs whose activities are governed by federal law, any future changes in laws that significantly affect the activity of these GSEs could, in turn, adversely affect our operations. In September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the U.S. government. The federal government has for many years considered proposals to reform Fannie Mae and Freddie Mac, but the results of any such reform, and their impact on us, are difficult to predict. To date, no reform proposal has been enacted.

In addition, our ability to sell mortgage loans readily is dependent upon our ability to remain eligible for the programs offered by the GSEs and other institutional and non-institutional investors. Any significant impairment of our eligibility with any of the GSEs could materially and adversely affect our operations. Further, the criteria for loans to be accepted under such programs may be changed from time to time by the sponsoring entity, which could result in a lower volume of corresponding loan originations. The profitability of participating in specific programs may vary depending on a number of factors, including our administrative costs of originating and purchasing qualifying loans and our costs of meeting such criteria.

***We may be liable to purchasers of mortgage loans and mortgage servicing rights, including as a result of any breach of representations and warranties we make to the purchasers.***

When we sell or securitize mortgage loans in the ordinary course of business, we are required to make certain representations and warranties to the purchaser about the mortgage loans and the manner in which they were originated. Under these agreements, we may be required to repurchase mortgage loans if we have breached any of these representations or warranties, in which case we may record a loss. In addition, if repurchase and indemnity demands increase on loans that we sell from our portfolios, our liquidity, results of operations and financial condition could be adversely affected. In addition, we have sold residential mortgage servicing rights to third parties pursuant to customary purchase agreements, under which we could be required to indemnify the purchasers for losses resulting from pre-closing servicing errors or breaches of our representations and warranties.

***Our ability to maintain our reputation is critical to the success of our business, and the failure to do so may materially adversely affect our business and the value of our stock.***

We are a community bank, and our reputation is one of the most valuable components of our business. Similarly, each of our subsidiaries operate in niche markets where reputation is critically important. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results and the value of our stock may be materially adversely affected.

***Our risk management framework may not be effective in mitigating risks and/or losses to us.***

Our risk management framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which we are subject, including, among others, credit, market, liquidity, interest rate and compliance. Our framework also includes financial or other modeling methodologies that involve management assumptions and judgment. Our risk management framework may not be effective under all circumstances or that it will adequately mitigate any risk or loss to us. If our framework is not effective, we could suffer unexpected losses and our business, financial condition, results of operations or growth prospects could be materially and adversely affected. We may also be subject to potentially adverse regulatory consequences.



***Changes in accounting standards could materially impact our financial statements.***

From time to time, the FASB or the SEC may change the financial accounting and reporting standards that govern the preparation of our financial statements. Such changes may result in us being subject to new or changing accounting and reporting standards. In addition, the bodies that interpret the accounting standards (such as banking regulators or outside auditors) may change their interpretations or positions on how these standards should be applied. These changes may be beyond our control, can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retrospectively, or apply an existing standard differently, also retrospectively, in each case resulting in our needing to revise or restate prior period financial statements.

***We are subject to potential claims and litigation pertaining to our fiduciary responsibilities.***

Some of the services we provide, such as wealth management services, require us to act as fiduciaries for our customers and others. From time to time, third parties make claims and take legal action against us pertaining to the performance of our fiduciary responsibilities. If these claims and legal actions are not resolved in a manner favorable to us, we may be exposed to significant financial liability and/or our reputation could be damaged. Either of these results may adversely impact demand for our products and services or otherwise have a harmful effect on our business and, in turn, on our financial condition and results of operations.

***We have a continuing need for technological change, and we may not have the resources to effectively implement new technology or we may experience operational challenges when implementing new technology.***

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our market area. We may experience operational challenges as we implement these new technology enhancements, or seek to implement them across all of our offices and business units, which could result in us not fully realizing the anticipated benefits from such new technology or require us to incur significant costs to remedy any such challenges in a timely manner.

Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, a risk exists that we will not be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

***Real estate market volatility and future changes in our disposition strategies could result in net proceeds that differ significantly from our other real estate owned fair value appraisals.***

As of December 31, 2018, we had \$3.5 million of other real estate owned. Our other real estate owned portfolio consists of properties that we obtained through foreclosure or through an in-substance foreclosure in satisfaction of loans. Properties in our other real estate owned portfolio are recorded at the lower of the recorded investment in the loans for which the properties previously served as collateral or the “fair value,” which represents the estimated sales price of the properties on the date acquired less estimated selling costs.

In response to market conditions and other economic factors, we may utilize alternative sale strategies other than orderly disposition as part of our other real estate owned disposition strategy, such as immediate liquidation sales. In this event, as a result of the significant judgments required in estimating fair value and the variables involved in different methods of disposition, the net proceeds realized from such sales transactions could differ significantly from appraisals, comparable sales and other estimates used to determine the fair value of our other real estate owned properties.

***Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.***

Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans or other real estate owned, thereby adversely affecting our net income and returns on assets and equity, increasing our loan administration costs and adversely affecting our efficiency ratio. When we take collateral in

foreclosure and similar proceedings, we are required to mark the collateral to its then-fair market value, which may result in a loss. These nonperforming loans and other real estate owned also increase our risk profile and the level of capital our regulators believe is appropriate for us to maintain in light of such risks. The resolution of nonperforming assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in nonperforming loans and nonperforming assets, our net interest income may be negatively impacted and our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

***We depend on the accuracy and completeness of information provided by customers and counterparties.***

In deciding whether to extend credit or enter into other transactions with customers and counterparties, we may rely on information furnished to us by or on behalf of customers and counterparties, including financial statements and other financial information. We also may rely on representations of customers and counterparties as to the accuracy and completeness of that information. In deciding whether to extend credit, we may rely upon our customers' representations that their financial statements conform to U.S. generally accepted accounting principles ("GAAP") and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. We also may rely on customer representations and certifications, or other audit or accountants' reports, with respect to the business and financial condition of our clients. Our financial condition, results of operations, financial reporting and reputation could be negatively affected if we rely on materially misleading, false, inaccurate or fraudulent information.

***We face strong competition from financial services companies and other companies that offer banking, mortgage, leasing, and wealth management services and providers of FHA financing and servicing, which could harm our business.***

Our operations consist of offering banking and mortgage services, and we also offer commercial FHA financing, trust, wealth management and leasing services to generate noninterest income. Many of our competitors offer the same, or a wider variety of, banking and related financial services within our market areas. These competitors include national banks, regional banks and other community banks. We also face competition from many other types of financial institutions, including savings and loan institutions, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. In addition, a number of out-of-state financial intermediaries have opened production offices or otherwise solicit deposits in our market areas. Additionally, we face growing competition from so-called "online businesses" with few or no physical locations, including online banks, lenders and consumer and commercial lending platforms, as well as automated retirement and investment service providers. Increased competition in our markets may result in reduced loans, deposits and commissions and brokers' fees, as well as reduced net interest margin and profitability. Ultimately, we may not be able to compete successfully against current and future competitors. If we are unable to attract and retain banking, mortgage, leasing and wealth management customers, we may be unable to continue to grow our business and our financial condition and results of operations may be adversely affected.

***Consumers and businesses are increasingly using non-banks to complete their financial transactions, which could adversely affect our business and results of operations.***

Technology and other changes are allowing consumers and businesses to complete financial transactions that historically have involved banks through alternative methods. For example, the wide acceptance of internet-based commerce has resulted in a number of alternative payment processing systems and lending platforms in which banks play only minor roles. Customers can now maintain funds in prepaid debit cards or digital currencies, and pay bills and transfer funds directly without the direct assistance of banks. The diminishing role of banks as financial intermediaries has resulted and could continue to result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the potential loss of lower cost deposits as a source of funds could have a material adverse effect on our business, financial condition and results of operations.

***If we violate U.S. Department of Housing and Urban Development ("HUD") lending requirements or if the federal government shuts down or otherwise fails to fully fund the federal budget, our commercial FHA origination business could be adversely affected.***

We originate, sell and service loans under FHA insurance programs, and make certifications regarding compliance with applicable requirements and guidelines. If we were to violate these requirements and guidelines, or other applicable laws, or if the FHA loans we originate show a high frequency of loan defaults, we could be subject to

monetary penalties and indemnification claims, and could be declared ineligible for FHA programs. Any inability to engage in our commercial FHA origination and servicing business would lead to a decrease in our net income.

In addition, disagreement over the federal budget has caused the U.S. federal government to shut down for periods of time in recent years. Federal governmental entities, such as HUD, that rely on funding from the federal budget, could be adversely affected in the event of a government shut-down, which could have a material adverse effect on our commercial FHA origination business and our results of operations.

### **Risks Related to the Business Environment and Our Industry**

#### ***Legislative and regulatory actions taken now or in the future may increase our costs and impact our business, governance structure, financial condition or results of operations.***

Compliance with the Dodd-Frank Act and its implementing regulations has resulted, and may continue to result, in additional operating and compliance costs that could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

In addition, new proposals for legislation may continue to be introduced in the U.S. Congress that could further substantially change regulation of the bank and non-bank financial services industries and impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied. Certain aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities, require more oversight or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations to comply and could have an adverse effect on our business, financial condition and results of operations.

#### ***As a result of the Dodd-Frank Act and subsequent rulemaking, we are subject to stringent capital requirements, and failure to comply with these requirements may impact dividend payments and limit our activities.***

The failure to meet applicable regulatory capital requirements of the Basel III Rule could result in one or more of our regulators placing limitations or conditions on our activities, including our growth initiatives, or restricting the commencement of new activities, and could affect customer and investor confidence, our costs of funds and FDIC insurance costs, our ability to pay dividends on our common stock, our ability to make acquisitions, and our business, results of operations and financial conditions, generally.

#### ***Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.***

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate and changes in banks' reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

#### ***Federal and state regulators periodically examine our business, and we may be required to remediate adverse examination findings.***

The Federal Reserve, the FDIC and the DFPR periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our

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operations had become unsatisfactory, or that we were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil money penalties, to fine or remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have an adverse effect on our business, financial condition and results of operations.

### ***We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.***

The CRA, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations prohibit discriminatory lending practices by financial institutions. The U.S. Department of Justice, federal banking agencies, and other federal agencies are responsible for enforcing these laws and regulations. A challenge to an institution’s compliance with fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Private parties may also challenge an institution’s performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

### ***We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.***

The Bank Secrecy Act, the USA PATRIOT Act and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file reports such as suspicious activity reports and currency transaction reports. We are required to comply with these and other anti-money laundering requirements. The federal banking agencies and Financial Crimes Enforcement Network are authorized to impose significant civil money penalties for violations of those requirements and have recently engaged in coordinated enforcement efforts against banks and other financial services providers with the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans.

Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

### ***The Federal Reserve may require us to commit capital resources to support the Bank.***

As a matter of policy, the Federal Reserve expects a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. The Dodd-Frank Act codified the Federal Reserve’s policy on serving as a source of financial strength. Under the “source of strength” doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank. A capital injection may be required at times when the holding company may not have the resources to provide it and therefore may be required to borrow the funds or raise capital. Any loans by a holding company to its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company’s bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution’s general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the Company to make a required capital injection becomes more difficult and expensive and could have an adverse effect on our business, financial condition and results of operations.

***A new accounting standard may require us to increase our allowance for loan losses and may have a material adverse effect on our financial condition and results of operations.***

The FASB has adopted a new accounting standard that will be effective for the Company and the Bank for our first fiscal year beginning after December 15, 2019. This standard, referred to as Current Expected Credit Loss (“CECL”), will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which may require us to increase our allowance for loan losses, and to greatly increase the types of data we will need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in our allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on our financial condition and results of operations.

***We may be adversely affected by the soundness of other financial institutions.***

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, and other relationships. We have exposure to different industries and counterparties, and through transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. These losses or defaults could have a material adverse effect on our business, financial condition, results of operations and growth prospects. Additionally, if our competitors were extending credit on terms we found to pose excessive risks, or at interest rates which we believed did not warrant the credit exposure, we may not be able to maintain our business volume and could experience deteriorating financial performance.

***The stock market can be volatile, and fluctuations in our operating results and other factors could cause our stock price to decline.***

The stock market has experienced and may continue to experience, fluctuations that significantly impact the market prices of securities issued by many companies. Market fluctuations could adversely affect our stock price. These fluctuations have often been unrelated or disproportionate to the operating performance of particular companies. These broad market fluctuations, as well as general economic, systematic, political and market conditions, such as recessions, loss of investor confidence, interest rate changes, or international currency fluctuations, may negatively affect the market price of our common stock. Moreover, our operating results may fluctuate and vary from period to period due to the risk factors set forth herein. As a result, period-to-period comparisons should not be relied upon as an indication of future performance. Our stock price could fluctuate significantly in response to our quarterly or annual results, annual projections and the impact of these risk factors on our operating results or financial position.

**Item 1B – Unresolved Staff Comments**

None.

**Item 2 – Properties**

Our corporate headquarters office building is located at 1201 Network Centre Drive, Effingham, Illinois, 62401. We own our corporate headquarters office building, which was built in 2011 and consists of approximately 79,000 square feet. The property also houses our primary operations center. We have an additional operations center located in St. Louis, Missouri, including for the Midland Equipment Financing operations, and Love Funding’s headquarters are located in Washington, D.C. At December 31, 2018, the Bank operated a total of 69 banking centers, including 58 located in Illinois and 11 located in the St. Louis metropolitan area. Of these facilities, 56 were owned and we leased 13 from unaffiliated third parties.

We believe that the leases to which we are subject are generally on terms consistent with prevailing market terms. None of the leases are with our directors, officers, beneficial owners of more than 5% of our voting securities or any affiliates of the foregoing. We believe that our facilities are in good condition and are adequate to meet our operating needs for the foreseeable future.

**Item 3 – Legal Proceedings**

In the normal course of business, we are named or threatened to be named as a defendant in various lawsuits, none of which we expect to have a material effect on the Company. However, given the nature, scope and complexity of the extensive legal and regulatory landscape applicable to our business (including laws and regulations governing consumer protection, fair lending, fair labor, privacy, information security, anti-money laundering and anti-terrorism), we, like all banking organizations, are subject to heightened legal and regulatory compliance and litigation risk. There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or any of its subsidiaries is a party or of which any of their property is the subject.

**Item 4 – Mine Safety Disclosures**

Not applicable.

PART II

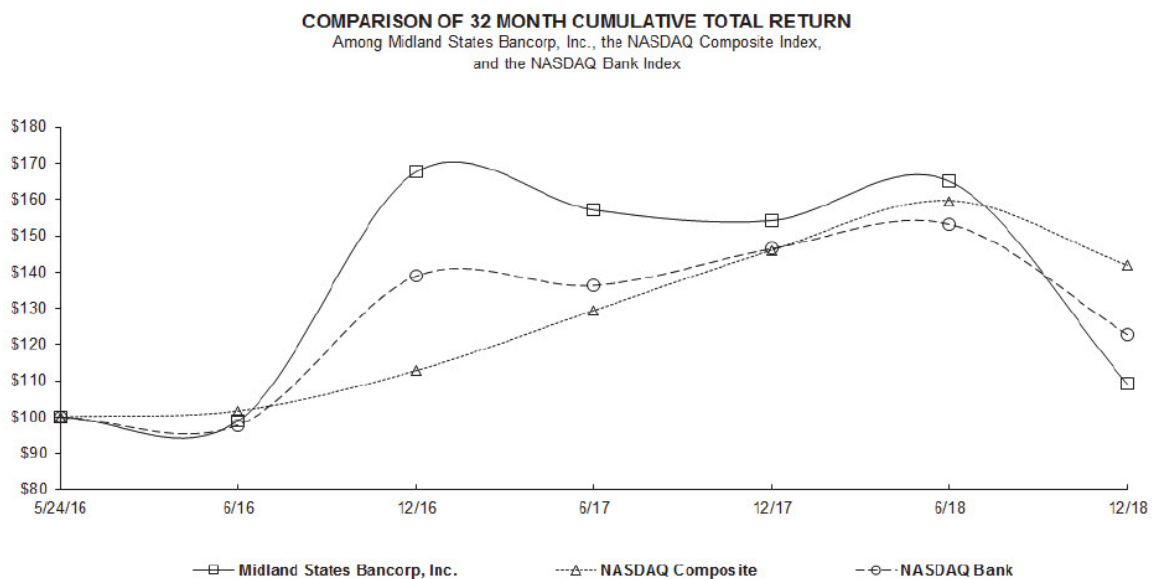
Item 5 – Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer of Purchases of Equity Securities

Shareholders

As of February 20, 2019, the Company had 1,025 common stock shareholders of record, and the closing price of the Company’s common stock, traded on the Nasdaq Global Select Market (“NASDAQ”) under the ticker symbol MSBI, was \$25.48 per share.

Stock Performance Graph

The following graph compares the cumulative total shareholder return on the Company’s common stock from May 24, 2016 (the date of the Company’s initial public offering and listing on Nasdaq) through December 31, 2018. The graph compares the Company’s common stock with the Nasdaq Composite Index and the Nasdaq Bank Index. The graph assumes an investment of \$100.00 in the Company’s common stock and each index on May 24, 2016 and reinvestment of all quarterly dividends. Measurement points are May 24, 2016 and the last trading day of each subsequent quarter end through December 31, 2018. There is no assurance that the Company’s common stock performance will continue in the future with the same or similar results as shown in the graph.



\*\$100 invested on 5/24/16 in stock and index, including reinvestment of dividends.  
Fiscal year ending December 31.

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**Issuer Purchases of Equity Securities**

The following table sets forth information regarding the Company’s repurchase of shares of its outstanding common stock during the fourth quarter of 2018.

Period	Total Number of Shares Purchased <sup>(1)</sup>	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
October 1 - 31, 2018	1,385	\$ 32.84	-	-
November 1 - 30, 2018	286	26.67	-	-
December 1 - 31, 2018	1,010	25.48	-	-
Total	2,681	\$ 29.41	-	-

(1) Represents shares of the Company’s common stock repurchased under the employee stock purchase program and/or shares withheld to satisfy tax withholding obligations upon the vesting of awards of restricted stock. These shares were purchased pursuant to the terms of the applicable plan and not pursuant to a publicly announced repurchase plan or program.

**Unregistered Sales of Equity Securities**

None.

**Item 6 – Selected Financial Data**

The following consolidated selected financial data is derived from the Company’s audited consolidated financial statements as of and for the five years ended December 31, 2018. This information should be read in connection with our audited consolidated financial statements, related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing elsewhere in this report.

	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
<i>(dollars in thousands)</i>					
<b>Balance Sheet Data:</b>					
Total assets	\$ 5,637,673	\$ 4,412,701	\$ 3,233,723	\$ 2,884,824	\$ 2,676,614
Total loans, gross	4,137,551	3,226,678	2,319,976	1,995,589	1,798,015
Allowance for loan losses	(20,903)	(16,431)	(14,862)	(15,988)	(12,300)
Loans held for sale	30,401	50,089	70,565	54,413	96,407
Investment securities	660,785	450,525	325,011	324,148	355,531
Deposits	4,074,170	3,131,089	2,404,366	2,367,648	2,150,633
Short-term borrowings	124,235	156,126	131,557	107,538	129,714
FHLB advances and other borrowings	640,631	496,436	237,518	40,178	74,349
Subordinated debt	94,134	93,972	54,508	61,859	7,370
Trust preferred debentures	47,794	45,379	37,405	37,057	36,930
Preferred shareholders’ equity	2,781	2,970	-	-	-
Common shareholders’ equity	605,744	446,575	321,770	232,880	219,456
Total shareholders’ equity	608,525	449,545	321,770	232,880	219,456
Tangible common equity <sup>(1)</sup>	403,695	331,019	265,747	179,357	162,046
<b>Income Statement Data:</b>					
Interest income	\$ 223,367	\$ 153,113	\$ 121,249	\$ 117,796	\$ 73,141
Interest expense	43,280	23,451	15,995	12,889	8,543
Net interest income	180,087	129,662	105,254	104,907	64,598
Provision for loan losses	9,430	9,556	5,591	11,127	92
Noninterest income	71,791	59,362	72,057	59,482	20,441
Noninterest expense	191,643	152,997	121,289	117,847	69,480
Income before taxes	50,805	26,471	50,431	35,415	15,467
Provision for income taxes	11,384	10,415	18,889	11,091	4,651
Net income	39,421	16,056	31,542	24,324	10,816
Preferred stock dividends	141	83	-	-	7,601
Net income available to common shareholders	\$ 39,280	\$ 15,973	\$ 31,542	\$ 24,324	\$ 3,215



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	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
<i>(dollars in thousands, except per share data)</i>					
<b>Credit Quality Data:</b>					
Loans 30-89 days past due	\$ 25,213	\$ 15,405	\$ 10,767	\$ 10,120	\$ 5,744
Loans 30-89 days past due to total loans	0.61 %	0.48 %	0.46 %	0.51 %	0.32 %
Nonperforming loans <sup>(2)</sup>	\$ 42,899	\$ 26,760	\$ 31,603	\$ 24,891	\$ 32,172
Nonperforming loans to total loans <sup>(2)</sup>	1.04 %	0.83 %	1.36 %	1.25 %	1.80 %
Nonperforming assets <sup>(3)</sup>	\$ 45,899	\$ 30,894	\$ 34,550	\$ 29,206	\$ 39,542
Nonperforming assets to total assets <sup>(3)</sup>	0.81 %	0.70 %	1.07 %	1.01 %	1.48 %
Allowance for loan losses to total loans <sup>(2)</sup>	0.51 %	0.51 %	0.64 %	0.80 %	0.69 %
Allowance for loan losses to nonperforming loans <sup>(2)</sup>	48.73 %	61.40 %	47.03 %	64.23 %	38.23 %
Net charge-offs to average loans	0.13 %	0.28 %	0.31 %	0.39 %	0.94 %
<b>Per Share Data (Common Stock):</b>					
Earnings:					
Basic	\$ 1.69	\$ 0.89	\$ 2.22	\$ 2.03	\$ 0.53
Diluted <sup>(4)</sup>	1.66	0.87	2.17	2.00	0.53
Dividends declared	0.88	0.80	0.72	0.65	0.59
Book value <sup>(5)</sup>	25.50	23.35	20.78	19.74	18.72
Tangible book value <sup>(1)</sup>	17.00	17.31	17.16	15.20	13.82
Market price	22.34	32.48	36.18	N/A	N/A
Weighted average shares outstanding:					
Basic	23,130,475	17,781,631	14,130,552	11,902,455	5,945,615
Diluted	23,549,025	18,283,214	14,428,839	12,112,403	6,025,454
Shares outstanding at period end	23,751,798	19,122,049	15,483,499	11,797,404	11,725,158
<b>Performance Metrics:</b>					
Return on average assets	0.72 %	0.41 %	1.03 %	0.88 %	0.62 %
Return on average shareholders' equity	6.92	4.02	10.95	10.68	6.82
Return on average common shareholders' equity	6.93	4.02	10.95	10.68	2.83
Return on average tangible common equity <sup>(1)</sup>	10.40	5.19	13.43	14.14	3.26
Yield on earning assets	4.65	4.43	4.51	4.91	4.74
Cost of average interest bearing liabilities	1.11	0.82	0.72	0.66	0.65
Net interest spread	3.54	3.61	3.79	4.25	4.09
Net interest margin <sup>(6)</sup>	3.76	3.77	3.92	4.38	4.21
Efficiency ratio <sup>(1)</sup>	66.08	66.66	68.66	66.20	71.07
Common stock dividend payout ratio <sup>(7)</sup>	52.07	89.89	32.43	32.02	111.32
Loan to deposit ratio	101.56	103.05	96.49	84.29	83.60
Core deposits/total deposits <sup>(8)</sup>	92.35	91.69	88.70	88.41	89.56
Net non-core funding dependence ratio <sup>(1)</sup>	17.89	19.95	15.23	7.12	10.50
<b>Regulatory and Other Capital Ratios - Consolidated:</b>					
Tangible common equity to tangible assets <sup>(1)</sup>	7.43 %	7.70 %	8.36 %	6.33 %	6.19 %
Tier 1 common capital to risk-weighted assets <sup>(9)</sup>	8.76	8.45	9.35	6.50	N/A
Tier 1 leverage ratio	8.53	8.63	9.76	7.49	10.48
Tier 1 capital to risk-weighted assets	10.25	10.19	11.27	8.62	8.65
Total capital to risk-weighted assets	12.79	13.26	13.85	11.82	9.59
<b>Regulatory Capital Ratios - Bank Only <sup>(10)</sup>:</b>					
Tier 1 common capital to risk-weighted assets <sup>(9)</sup>	12.27 %	11.84 %	11.61 %	10.39 %	N/A
Tier 1 leverage ratio	10.22	10.04	10.05	9.01	8.65 %
Tier 1 capital to risk-weighted assets	12.27	11.84	11.61	10.39	10.34
Total capital to risk-weighted assets	12.76	12.32	12.17	11.06	11.18

- (1) Tangible common equity, tangible book value per share, return on average tangible common equity, tangible common equity to tangible assets, efficiency ratio and net non-core funding dependence ratio are non-GAAP financial measures. See "—Non-GAAP Financial Measures," below for a reconciliation of these measures to their most comparable GAAP measures.
- (2) Nonperforming loans include nonaccrual loans, loans past due 90 days or more and still accruing interest and loans modified under troubled debt restructurings ("TDR"). Nonperforming loans exclude purchased credit-impaired loans ("PCI loans") acquired in our prior acquisitions. PCI loans had carrying values of \$43.0 million, \$22.5 million, \$28.3 million, \$38.5 million and \$44.2 million as of December 31, 2018, 2017, 2016, 2015, and 2014, respectively. Furthermore, PCI loans, as well as other loans acquired in a business combination, are recorded at estimated fair value on their purchase date without a carryover of the related allowance for loan losses. Accordingly, our ratios that are computed using nonperforming loans and/or allowance for loan losses may not be comparable to similar ratios of our peers.
- (3) Nonperforming assets include nonperforming loans, other real estate owned and other repossessed assets. Nonperforming assets exclude covered other real estate owned related to FDIC-assisted transactions. As discussed in footnote 2 above, nonperforming loans exclude PCI loans. This ratio may therefore not be comparable to a similar ratio of our peers.
- (4) Earnings per share are calculated utilizing the two-class method. Basic earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of common

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shares outstanding. Diluted earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of shares adjusted for the dilutive effect of outstanding stock options and common stock warrants using the treasury stock method and convertible preferred stock and convertible debentures using the if-converted method. For the year ended December 31, 2014, diluted earnings per share considered, when dilutive, the weighted average shares of common stock issuable upon conversion of our Series C preferred stock, Series D preferred stock, Series E preferred stock and Series F preferred stock then outstanding. During 2014, our Series C, D, E and F preferred stock was converted into shares of common stock. We did not have any preferred stock during 2015 or 2016 or any warrants to acquire preferred stock outstanding during 2015, 2016, 2017 or 2018.

- (5) For purposes of computing book value per common share, book value equals total common shareholders' equity.
- (6) Net interest margin is presented on a fully taxable equivalent ("FTE") basis.
- (7) Common stock dividend payout ratio represents dividends per share divided by basic earnings per share.
- (8) Core deposits are defined as total deposits less certificate of deposits greater than \$250,000 and brokered certificates of deposits.
- (9) The Tier 1 common capital to risk-weighted assets ratio is required under the Basel III Rule, which became effective for the Company and the Bank on January 1, 2015. Accordingly, this ratio is shown as not applicable ("N/A") for periods ending prior to January 1, 2015.
- (10) On December 31, 2014, we completed our acquisition of Love Savings Holding Company, which primarily consisted of Heartland Bank and its wholly owned subsidiaries Love Funding and Heartland Business Credit Corporation. For the purpose of comparability with prior periods presented, the "bank only" regulatory capital ratios as of December 31, 2014 represent Midland States Bank ratios only and do not include Heartland Bank. The Tier 1 leverage ratio, Tier 1 capital to risk-weighted assets ratio and total capital to risk-weighted assets ratio for Heartland Bank as of December 31, 2014 were 8.76%, 11.77% and 13.03%, respectively.

## **Non-GAAP Financial Measures**

Our management uses the following non-GAAP financial measures in its analysis of our performance: "tangible common equity," "tangible common equity to tangible assets," "tangible book value per share," "return on average tangible common equity," "efficiency ratio," and "net non-core funding dependence ratio."

***Tangible Common Equity, Tangible Common Equity to Tangible Assets Ratio and Tangible Book Value Per Share.*** Tangible common equity, tangible common equity to tangible assets ratio and tangible book value per share are non-GAAP measures generally used by financial analysts and investment bankers to evaluate capital adequacy. We calculate: (i) tangible common equity as total shareholders' equity less preferred equity, goodwill and other intangible assets (excluding mortgage servicing rights); (ii) tangible assets as total assets less goodwill and other intangible assets; and (iii) tangible book value per share as tangible common equity divided by shares of common stock outstanding.

Our management, banking regulators, many financial analysts and other investors use these measures in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of preferred equity and/or goodwill or other intangible assets, which typically stem from the use of the purchase accounting method of accounting for mergers and acquisitions. Tangible common equity, tangible assets, tangible book value per share and related measures should not be considered in isolation or as a substitute for total shareholders' equity, total assets, book value per share or any other measure calculated in accordance with GAAP. Moreover, the manner in which we calculate tangible common equity, tangible assets, tangible book value per share and any other related measures may differ from that of other companies reporting measures with similar names. The following table reconciles shareholders' equity (on a GAAP basis) to tangible common equity and total assets (on a GAAP basis) to tangible assets, and calculates our tangible book value per share:

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	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
<i>(dollars in thousands, except per share data)</i>					
<b>Shareholders' Equity to Tangible Common Equity:</b>					
Total shareholders' equity—GAAP	\$ 608,525	\$ 449,545	\$ 321,770	\$ 232,880	\$ 219,456
Adjustments:					
Preferred equity	(2,781)	(2,970)	-	-	-
Goodwill	(164,673)	(98,624)	(48,836)	(46,519)	(47,946)
Other intangibles	(37,376)	(16,932)	(7,187)	(7,004)	(9,464)
<b>Tangible common equity</b>	<b>\$ 403,695</b>	<b>\$ 331,019</b>	<b>\$ 265,747</b>	<b>\$ 179,357</b>	<b>\$ 162,046</b>
<b>Total Assets to Tangible Assets:</b>					
Total assets—GAAP	\$ 5,637,673	\$ 4,412,701	\$ 3,233,723	\$ 2,884,824	\$ 2,676,614
Adjustments:					
Goodwill	(164,673)	(98,624)	(48,836)	(46,519)	(47,946)
Other intangibles	(37,376)	(16,932)	(7,187)	(7,004)	(9,464)
<b>Tangible assets</b>	<b>\$ 5,435,624</b>	<b>\$ 4,297,145</b>	<b>\$ 3,177,700</b>	<b>\$ 2,831,301</b>	<b>\$ 2,619,204</b>
<b>Common shares outstanding</b>	<b>23,751,798</b>	<b>19,122,049</b>	<b>15,483,499</b>	<b>11,797,404</b>	<b>11,725,158</b>
<b>Tangible common equity to tangible assets ratio</b>	<b>7.43 %</b>	<b>7.70 %</b>	<b>8.36 %</b>	<b>6.33 %</b>	<b>6.19 %</b>
<b>Tangible book value per share</b>	<b>\$ 17.00</b>	<b>\$ 17.31</b>	<b>\$ 17.16</b>	<b>\$ 15.20</b>	<b>\$ 13.82</b>

**Return on Average Tangible Common Equity.** Management measures return on average tangible common equity to assess the Company's capital strength and business performance. Tangible equity excludes preferred equity, goodwill and other intangible assets (excluding mortgage servicing rights), and is reviewed by banking and financial institution regulators when assessing a financial institution's capital adequacy. This non-GAAP financial measure should not be considered a substitute for operating results determined in accordance with GAAP and may not be comparable to other similarly titled measures used by other companies. The following table reconciles return on average tangible common equity to its most comparable GAAP measure:

	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
<i>(dollars in thousands)</i>					
<b>Net Income</b>	<b>\$ 39,421</b>	<b>\$ 16,056</b>	<b>\$ 31,542</b>	<b>\$ 24,324</b>	<b>\$ 10,816</b>
Less—preferred stock dividends	141	83	-	-	7,601
<b>Net income available to common shareholders</b>	<b>\$ 39,280</b>	<b>\$ 15,973</b>	<b>\$ 31,542</b>	<b>\$ 24,324</b>	<b>\$ 3,215</b>
<b>Average Shareholders' Equity to Average Tangible Common Equity:</b>					
Average total shareholders' equity—GAAP	\$ 569,537	\$ 399,061	\$ 288,010	\$ 227,619	\$ 158,562
Adjustments:					
Preferred equity	(2,882)	(1,707)	-	-	(45,057)
Goodwill	(151,546)	(76,394)	(46,537)	(47,306)	(7,842)
Other intangibles	(37,507)	(13,437)	(6,575)	(8,249)	(7,117)
<b>Average tangible common equity</b>	<b>\$ 377,602</b>	<b>\$ 307,523</b>	<b>\$ 234,898</b>	<b>\$ 172,064</b>	<b>\$ 98,546</b>
<b>Return on average tangible common equity</b>	<b>10.40% %</b>	<b>5.19% %</b>	<b>13.43 %</b>	<b>14.14 %</b>	<b>3.26 %</b>

**Efficiency Ratio.** Management uses the efficiency ratio to measure how effective the Bank is in using overhead expenses, including salaries and benefit costs and occupancy expenses as well as other operating expenses, in generating revenues. We believe that this non-GAAP financial measure provides meaningful information to further assist investors in evaluating our operating results. This non-GAAP financial measure should not be considered a substitute for operating results determined in accordance with GAAP and may not be comparable to other similarly titled measures used by other companies. The following table reconciles the efficiency ratio to its most comparable GAAP measure:

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	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
<i>(dollars in thousands)</i>					
Noninterest expense	\$ 191,643	\$ 152,997	\$ 121,289	\$ 117,847	\$ 69,480
Adjustments to noninterest expense:					
Foundation contribution	-	-	-	-	(900)
Expense from payoff of subordinated debt	-	-	(511)	-	-
Net expense from FDIC loss share termination agreement	-	-	(351)	-	-
Branch network optimization plan charges	-	(1,952)	(2,099)	-	-
Loss on mortgage servicing rights held for sale	(458)	(4,059)	-	-	-
Integration and acquisition expenses	(24,015)	(17,738)	(2,343)	(6,101)	(6,229)
Adjusted noninterest expense	\$ 167,170	\$ 129,248	\$ 115,985	\$ 111,746	\$ 62,351
Net interest income	\$ 180,087	\$ 129,662	\$ 105,254	\$ 104,907	\$ 64,598
Effect of tax-exempt income	2,095	2,691	2,579	2,741	2,901
Adjusted net interest income	182,182	132,353	107,833	107,648	67,499
Noninterest income	71,791	59,362	72,057	59,482	20,441
Adjustments to noninterest income:					
Mortgage servicing rights (recovery) impairment	(450)	2,324	3,135	448	(84)
Gain on sales of investment securities, net	(464)	(222)	(14,702)	(193)	(77)
Other income	(89)	67	608	1,412	(46)
Adjusted noninterest income	70,788	61,531	61,098	61,149	20,234
Adjusted total revenue	\$ 252,970	\$ 193,884	\$ 168,931	\$ 168,797	\$ 87,733
Efficiency Ratio	66.08 %	66.66 %	68.66 %	66.20 %	71.07 %

**Net Non-Core Funding Dependence Ratio.** Management uses the net non-core funding dependence ratio to assess the Company's ability to fund short-term investments with the use of non-core liabilities rather than long-term assets. The net non-core funding dependence ratio is reviewed by banking and financial institution regulators when assessing a financial institution's ability to meet its liquidity needs. We believe that this non-GAAP financial measure provides meaningful information to further assist investors in evaluating our operating results. This non-GAAP financial measure should not be considered a substitute for operating results determined in accordance with GAAP and may not be comparable to other similarly titled measures used by other companies. The following table reconciles the net non-core funding dependence ratio to its most comparable GAAP measure:

	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
<i>(dollars in thousands)</i>					
<b>Short term assets:</b>					
Interest bearing bank balances including federal funds	\$ 132,444	\$ 147,478	\$ 146,485	\$ 167,140	\$ 108,890
Federal Home Loan Bank	104	43	413	109	293
Securities < 1 year	61,742	19,242	96,671	27,600	4,060
Short-term investments	\$ 194,290	\$ 166,763	\$ 243,569	\$ 194,849	\$ 113,243
<b>Long term assets:</b>					
Total securities	\$ 703,257	\$ 482,047	\$ 343,850	\$ 339,620	\$ 363,827
Less non-marketable equity securities	42,472	34,796	19,485	-	-
Less securities < 1 year	61,741	19,242	96,671	27,600	4,060
Long term securities	599,044	428,009	227,694	312,020	359,767
Total net loan including loans held for sale	4,147,049	3,264,936	2,375,679	1,979,601	1,790,791
Other real estate owned	3,483	5,708	3,560	5,472	9,829
Long term assets	\$ 4,749,576	\$ 3,698,653	\$ 2,606,933	\$ 2,297,093	\$ 2,160,387
<b>Non-core liabilities</b>					
CDs & IRAs > \$250K	\$ 75,976	\$ 69,873	\$ 52,919	\$ 52,197	\$ 56,296
Repurchase Agreements	124,235	156,126	131,557	43,958	55,861
Other borrowed money	607,609	459,141	237,517	40,000	60,000
Brokered deposits	236,167	219,404	218,720	222,269	167,964
Total non-core liabilities	1,043,987	904,544	640,713	358,424	340,121
Less short-term investments	194,290	166,763	243,569	194,849	113,243
Net non-core funding	\$ 849,697	\$ 737,781	\$ 397,144	\$ 163,575	\$ 226,878
Net non-core funding dependence ratio	17.89 %	19.95 %	15.23 %	7.12 %	10.50 %

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our “Selected Financial Data,” our consolidated financial statements and related notes thereto, and the other financial data appearing elsewhere in this report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Certain risks, uncertainties and other factors, including but not limited to those set forth under “Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995,” “Item 1A – Risk Factors” and elsewhere in this report, may cause actual results to differ materially from those projected in the forward-looking statements. We assume no obligation to update any of these forward-looking statements. Readers of our Annual Report on Form 10-K should therefore consider these risks and uncertainties in evaluating forward-looking statements and should not place undue reliance on forward-looking statements.*

## **Overview**

Midland States Bancorp, Inc. is a diversified financial holding company headquartered in Effingham, Illinois. Its wholly-owned banking subsidiary, Midland States Bank, has branches across Illinois and in Missouri, and provides a full range of commercial and consumer banking products and services, business equipment financing, merchant credit card services, trust and investment management, and insurance and financial planning services. In addition, multifamily and healthcare facility FHA financing is provided through Love Funding, our non-bank subsidiary. As of December 31, 2018, we had \$5.64 billion in assets, \$4.07 billion of deposits and \$608.5 million of shareholders’ equity.

Our strategic plan is focused on building a diversified financial services company anchored by a strong community bank. In the past several years, we have grown organically and through a series of acquisitions, with an over-arching focus on enhancing shareholder value and maintaining a platform for scalability. In June 2017, we completed the acquisition of Centruze and its subsidiary, Centruze Bank, a regional, full-service community bank headquartered in Ottawa, Illinois. At closing, Centruze had 20 bank branches located principally in northern Illinois and total assets of \$990.2 million. Most recently, on February 28, 2018, the Company completed the acquisition of Alpine, and its subsidiary, Alpine Bank, a regional, full-service community bank headquartered in Belvidere, Illinois. Alpine had 19 bank branches located principally in and around the Rockford, Illinois area and had total assets of \$1.24 billion.

We have five principal business lines: traditional community banking, residential mortgage origination, wealth management, commercial FHA origination and servicing, and commercial equipment financing. Our traditional community banking business primarily consists of commercial and retail lending and deposit taking with a total loan portfolio of \$4.12 billion and total deposits of \$4.07 billion as of December 31, 2018. Through the Bank, we originated \$318.0 million of residential mortgage loans in 2018, which included \$242.6 million of loans classified as held for sale. Our wealth management group provides a comprehensive suite of trust and wealth management products and services, and has grown to \$2.95 billion of assets under administration as of December 31, 2018. Our commercial FHA business, which originates commercial mortgage loans for multifamily and healthcare facilities under FHA insurance programs, had \$314.7 million of originations for the year ended December 31, 2018. Our equipment financing business, which provides custom leasing and financing programs to equipment and software vendors and their customers, had loan and lease originations of \$170.4 million in 2018.

Our principal business activity has been lending to and accepting deposits from individuals, businesses, municipalities and other entities. We have derived income principally from interest charged on loans and leases and, to a lesser extent, from interest and dividends earned on investment securities. We have also derived income from noninterest sources, such as: fees received in connection with various lending and deposit services; wealth management services; commercial FHA mortgage loan originations, sales and servicing; residential mortgage loan originations and sales; and, from time to time, gains on sales of assets. Our principal expenses include interest expense on deposits and borrowings, operating expenses, such as salaries and employee benefits, occupancy and equipment expenses, data processing costs, professional fees and other noninterest expenses, provisions for loan losses and income tax expense.

## **Primary Factors Affecting Comparability**

Each factor listed below materially affects the comparability of our results of operations and financial condition in 2018, 2017 and 2016, and may affect the comparability of financial information we report in future fiscal periods.

**Recent Acquisitions.** We have completed several acquisitions in recent years, but the results and other financial data of these acquired operations are not included in our financial results for the periods prior to their respective

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acquisition dates. Therefore, the financial data for these prior periods is not comparable in all respects and is not necessarily indicative of our future results. The following table summarizes our pending and completed acquisitions since December 31, 2015:

<u>Date</u>	<u>Target</u>	<u>Type</u>	<u>Description and Highlights</u>
February 28, 2018	Alpine Bancorporation, Inc. <i>Belvidere, IL</i>	Holding company acquisition	<ul style="list-style-type: none"> <li>Acquisition of \$1.24 billion community bank holding company, which significantly enhanced our presence in Rockford, Illinois through the addition of 19 bank branches, most of which are located in and around Rockford, Illinois.</li> <li>Acquisition included Alpine Trust and Investment Group, which had \$1.0 billion in assets under administration.</li> </ul>
June 9, 2017	Centrue Financial Corporation <i>Ottawa, IL</i>	Holding company acquisition	<ul style="list-style-type: none"> <li>Significantly enhanced our presence in northern Illinois through the addition of 20 bank branches, most of which were located in northern Illinois.</li> </ul>
March 28, 2017	CedarPoint Investment Advisors, Inc. <i>Delafield, WI</i>	Acquisition of business line	<ul style="list-style-type: none"> <li>Acquisition of SEC registered investment advisory firm with approximately \$180.0 million in assets under administration.</li> </ul>
November 10, 2016	Trust Department of Sterling National Bank <i>Yonkers, NY</i>	Acquisition of business line	<ul style="list-style-type: none"> <li>Acquisition of litigation settlement trust business with approximately \$400.0 million in trust assets under administration.</li> </ul>

**Capital Raising Transactions.** We completed several significant capital transactions to support our organic growth and acquisition activity. Each of the following capital raising transactions affected the comparability of our results of operations and financial condition of prior periods to post-transaction periods and may affect the comparability of financial information we report in future fiscal periods.

In October 2017, we issued subordinated notes totaling \$40.0 million with a maturity date of October 15, 2027. These notes carry a fixed interest rate of 6.25% for the first five years and a floating rate equal to three-month LIBOR plus 423 basis points thereafter.

In May 2017, we entered into a loan agreement with another bank for a revolving line of credit in the original principal amount of up to \$10.0 million and a term loan in the original principal amount of \$40.0 million. The term loan matures on May 25, 2020 and carries a variable rate of interest equal to one-month LIBOR plus 2.25%. The revolving line of credit matures on May 23, 2019.

**PCI Loans.** Our net interest margin benefits from favorable changes in expected cash flows on our PCI loans and from accretion income associated with purchase accounting discounts established on the Non-Purchased Credit

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Impaired (“Non-PCI”) loans included in our acquisitions. Our reported net interest margins were 3.76%, 3.77% and 3.92% for 2018, 2017 and 2016, respectively. Accretion income associated with purchase accounting discounts established on loans acquired totaled \$13.4 million, \$9.7 million and \$11.7 million in 2018, 2017 and 2016, respectively, increasing the reported margins by 24, 25 and 38 basis points for each respective period.

During the second quarter of 2016, we received payment in full on a PCI loan that was a covered asset from an FDIC-assisted acquisition. We recognized the financial impact of this transaction by recording \$1.8 million of accretion income into interest income on loans and a \$0.8 million credit against the provision for loan losses offsetting the allowance amount that was previously recorded against this loan. In accordance with the loss-sharing agreement with the FDIC, we also recorded loss-sharing expense of \$1.5 million for reimbursement of covered losses previously paid by the FDIC on this loan.

**Mortgage Servicing Rights.** The Company sells residential and commercial FHA mortgage loans in the secondary market. Mortgage servicing rights (“MSR”) resulting from us retaining the right to service the loans sold are carried at the lower of the initial capitalized amount, net of accumulated amortization, or estimated fair value. MSR are amortized in proportion to and over the period of estimated net servicing income, and assessed for impairment at each reporting date.

During the third quarter of 2017, we committed to a plan to sell our Fannie Mae residential mortgage servicing and transferred \$14.2 million of residential MSR, net of valuation allowances, to MSR held for sale. As a result, we recognized a \$4.1 million loss in 2017 on MSR held for sale to reflect the lower of their carrying amount or fair value less costs to sell. After recognizing this loss, MSR held for sale had a net carrying value of \$10.2 million at December 31, 2017. We sold our Fannie Mae residential mortgage servicing on January 2, 2018.

During the second quarter of 2018, the Company transferred the remaining \$3.6 million of residential MSR to MSR held for sale. A loss of \$0.5 million was recognized on MSR held for sale during 2018.

There were no impairment charges on our residential mortgage servicing rights in 2018 compared to \$0.8 million in 2017 and \$1.4 million in 2016. For our commercial FHA mortgage servicing rights in 2018, we recognized \$0.5 million in recoveries of previously recorded impairment charges compared to impairment charges of \$1.5 million and \$1.7 million recognized in 2017 and 2016.

**Sale of Previously Covered Non-Agency Mortgage-Backed Securities** – In October 2016, we sold previously covered non-agency mortgage-backed securities (“CMOs”) with a carrying value of \$72.1 million. These securities were covered under the loss-sharing agreement we entered into with the FDIC in connection with our 2009 acquisition of Strategic Capital Bank. This agreement was terminated on October 3, 2016. As a result of the sale, we recognized a gain totaling \$14.3 million in the fourth quarter of 2016.

**Branch Network Optimization Plan** – In November 2016, we announced a branch network optimization plan that led to the closure of seven banking offices in the first quarter of 2017. As a result of this plan, we recorded \$1.9 million of asset impairment in 2016 on these banking facilities. In 2017, the Company announced the closure of six additional banking facilities as a result of the Centru acquisition. Consequently, we recorded \$2.0 million of asset impairment in 2017 on these banking facilities. There was no impairment recorded in 2018. We had \$1.7 million and \$3.4 million of branch-related assets classified in other assets as held for sale at December 31, 2018 and 2017, respectively.

## **Material Trends and Developments**

**Economic and Interest Rate Environment.** The results of our operations are highly dependent on economic conditions and market interest rates. Over the past several years, economic conditions in the U.S. and our primary market areas have improved. Economic growth has been modest, the real estate market continues to improve and unemployment rates in the U.S. and our primary markets have significantly fallen. In December 2015, the Federal Reserve raised short-term interest rates for the first time in nine years with a 25 basis point increase. Since then, the Federal Reserve has raised short-term interest rates an additional 25 basis points a total of eight times – once in 2016, three times in 2017 and four times in 2018.



**Capital Raising Initiatives.** One component of our initiative driven strategic plan is to pursue accretive acquisitions. We have been able to implement our acquisition strategy due to several significant capital raising transactions. These transactions are described above in the section under “*Primary Factors Affecting Comparability—Capital Raising Transactions.*” These capital raising transactions have also support our organic growth strategies.

**Community Banking.** We believe the most important trends affecting community banks in the United States over the foreseeable future will be related to heightened regulatory capital requirements, increasing regulatory burdens generally, including the implementation of the Dodd-Frank Act and the regulations to be promulgated thereunder, and interest margin compression. We expect that community banks will face increased competition for lower cost capital as a result of regulatory policies that may offer larger financial institutions greater access to government assistance than is available for smaller institutions, including community banks. We expect that troubled community banks will continue to face significant challenges when attempting to raise capital. We also believe that heightened regulatory capital requirements will make it more difficult for even well-capitalized, healthy community banks to grow in their communities by taking advantage of opportunities in their markets that result as the economy continues to improve. We believe these trends will favor community banks that have sufficient capital, a diversified business model and a strong deposit franchise, and we believe we possess these characteristics.

We also believe that increased regulatory burdens will have a significant adverse effect on smaller community banks, which often lack the personnel, experience and technology to efficiently comply with new regulations in a variety of areas in the banking industry, including in the areas of deposits, lending, compensation, information security and overdraft protection. We believe the increased costs to smaller community banks from a more complex regulatory environment, coupled with challenges in the real estate lending area, present attractive acquisition opportunities for larger community banks that have already made significant investments in regulatory compliance and risk management and can acquire and quickly integrate these smaller institutions into their existing platform. Furthermore, we believe that, as a result of our significant operational investments and our experience acquiring other institutions and quickly integrating them into our organization, we are well positioned to capitalize on the challenges facing smaller community banks.

We continue to believe we have significant opportunities for further growth through additional acquisitions of banks, branches, wealth management firms and trust departments of community banks, selective *de novo* opportunities, continued expansion of our wealth management operations, the hiring of commercial banking and wealth management professionals from other organizations and organic growth within our existing branch network. We also believe we have the necessary experience, management and infrastructure to take advantage of these growth opportunities.

**Credit Reserves.** One of our key operating objectives has been, and continues to be, maintenance of an appropriate level of reserve protection against probable losses in our loan portfolio. In 2018, our provision for loan losses was \$9.4 million compared to \$9.6 million in 2017 and \$5.6 million in 2016.

As noted above, we record PCI loans at estimated fair value on their acquisition date without a carryover of the related allowance for loan losses. As a result of adding \$786.2 million of loans from the Alpine acquisition and \$679.6 million of loans from the Centruac acquisition (which included PCI loans of \$35.0 million and \$11.4 million, respectively), combined with net loan charge-offs of \$5.0 million and \$8.0 million during 2018 and 2017, respectively, our allowance for loan losses as a percentage of total loans declined to 0.51% and 0.51% at December 31, 2018 and 2017, respectively, from 0.64% at December 31, 2016.

**Regulatory Environment.** As a result of regulatory changes, including the Dodd-Frank Act and the Basel III Rule, we expect to be subject to more restrictive capital requirements, more stringent asset concentration and growth limitations and new and potentially heightened examination and reporting requirements. We also expect to face a more challenging environment for customer loan demand due to the increased costs that could be ultimately borne by borrowers, and to incur higher costs to comply with these new regulations. This uncertain regulatory environment could have a detrimental impact on our ability to manage our business consistent with historical practices and cause difficulty in executing our growth plan. See “Item 1A. Risk Factors—Risks Related to Our Business” and “Item 1. Business—Supervision and Regulation.”

## Average Balance Sheet, Interest and Yield/Rate Analysis

The following table presents average balance sheet information, interest income, interest expense and the corresponding average yields earned and rates paid for the years ended December 31, 2018, 2017 and 2016. The average balances are principally daily averages and, for loans, include both performing and nonperforming balances. Interest income on loans includes the effects of discount accretion and net deferred loan origination costs accounted for as yield adjustments.

(tax-equivalent basis, dollars in thousands)	Year Ended December 31,								
	2018			2017			2016		
	Average Balance	Interest & Fees	Yield / Rate	Average Balance	Interest & Fees	Yield / Rate	Average Balance	Interest & Fees	Yield / Rate
<b>EARNING ASSETS:</b>									
Federal funds sold & cash investments	\$ 168,902	\$ 3,176	1.88 %	\$ 183,263	\$ 1,965	1.07 %	\$ 187,667	\$ 948	0.50 %
<i>Investment securities:</i>									
Taxable investment securities	503,375	13,894	2.76	298,771	6,763	2.26	219,549	9,294	4.23
Investment securities exempt from federal income tax <sup>(1)</sup>	160,997	5,764	3.58	108,487	5,756	5.31	100,128	5,591	5.58
Total securities	664,372	19,658	2.96	407,258	12,519	3.07	319,677	14,885	4.62
<i>Loans:</i>									
Loans <sup>(2)</sup>	3,832,357	194,688	5.08	2,795,615	135,898	4.86	2,103,319	102,211	4.86
Loans exempt from federal income tax <sup>(1)</sup>	96,717	4,211	4.35	45,989	1,931	4.20	40,468	1,777	4.39
Total loans	3,929,074	198,899	5.06	2,841,604	137,829	4.85	2,143,787	103,988	4.85
Loans held for sale	43,235	1,749	4.05	55,555	2,297	4.13	79,120	3,320	4.20
Nonmarketable equity securities	39,839	1,980	4.97	26,855	1,194	4.45	17,395	687	3.95
Total earning assets	4,845,422	225,462	4.65	3,514,535	155,804	4.43	2,747,646	123,828	4.51
Noninterest-earning assets	610,401			426,737			327,488		
Total assets	\$ 5,455,823			\$ 3,941,272			\$ 3,075,134		
<b>INTEREST-BEARING LIABILITIES</b>									
Checking and money market deposits	\$ 1,794,407	\$ 9,699	0.54 %	\$ 1,305,551	\$ 3,984	0.31 %	\$ 1,020,311	\$ 1,880	0.18 %
Savings deposits	426,525	749	0.18	234,143	359	0.15	163,392	245	0.15
Time deposits	624,113	7,664	1.23	458,257	4,099	0.89	430,144	3,847	0.89
Brokered deposits	188,993	3,942	2.09	247,819	3,690	1.49	215,865	2,964	1.37
Total interest-bearing deposits	3,034,038	22,054	0.73	2,245,770	12,132	0.54	1,829,712	8,936	0.49
Short-term borrowings	138,135	698	0.51	163,461	379	0.23	130,230	303	0.23
FHLB advances and other borrowings	579,624	11,347	1.96	362,320	4,594	1.27	158,609	1,057	0.67
Subordinated debt	94,055	6,056	6.44	63,186	4,054	6.42	58,110	3,858	6.64
Trust preferred debentures	47,551	3,125	6.57	41,798	2,292	5.48	37,225	1,841	4.95
Total interest-bearing liabilities	3,893,403	43,280	1.11	2,876,535	23,451	0.82	2,213,886	15,995	0.72
<b>NONINTEREST-BEARING LIABILITIES</b>									
Noninterest-bearing deposits	947,328			620,559			536,965		
Other noninterest-bearing liabilities	45,555			45,117			36,273		
Total noninterest-bearing liabilities	992,883			665,676			573,238		
Shareholders' equity	569,537			399,061			288,010		
Total liabilities and shareholders' equity	\$ 5,455,823			\$ 3,941,272			\$ 3,075,134		
Net interest income / net interest margin <sup>(3)</sup>		\$ 182,182	3.76 %		\$ 132,353	3.77 %		\$ 107,833	3.92 %

(1) Interest income and average rates for tax-exempt loans and securities are presented on a tax-equivalent basis, assuming a statutory federal income tax rate of 21% for 2018 and 35% for 2017 and 2016. Tax-equivalent adjustments totaled \$2.1 million, \$2.7 million and \$2.6 million for the years ended December 31, 2018, 2017 and 2016, respectively.

(2) Average loan balances include nonaccrual loans and loans held for sale. Interest income on loans includes amortization of deferred loan fees, net of deferred loan costs.

(3) Net interest margin during the periods presented represents: (i) the difference between interest income on interest-earning assets and the interest expense on interest-bearing liabilities, divided by (ii) average interest-earning assets for the period.

**Interest Rates and Operating Interest Differential**

Increases and decreases in interest income and interest expense result from changes in average balances (volume) of interest-earning assets and interest-bearing liabilities, as well as changes in average interest rates. The following table shows the effect that these factors had on the interest earned on our interest-earning assets and the interest incurred on our interest-bearing liabilities. The effect of changes in volume is determined by multiplying the change in volume by the previous period's average rate. Similarly, the effect of rate changes is calculated by multiplying the change in average rate by the previous period's volume. Changes which are not due solely to volume or rate have been allocated proportionally to the change due to volume and the change due to rate.

(tax-equivalent basis, dollars in thousands)	Year Ended December 31, 2018 Compared with Year Ended December 31, 2017			Year Ended December 31, 2017 Compared with Year Ended December 31, 2016		
	Change due to:		Interest Variance	Change due to:		Interest Variance
	Volume	Rate		Volume	Rate	
<b>EARNING ASSETS:</b>						
Federal funds sold & cash investments	\$ (212)	\$ 1,423	\$ 1,211	\$ (35)	\$ 1,052	\$ 1,017
<i>Investment securities:</i>						
Taxable investment securities	5,139	1,992	7,131	2,574	(5,105)	(2,531)
Investment securities exempt from federal income tax	2,333	(2,325)	8	455	(290)	165
Total securities	7,472	(333)	7,139	3,029	(5,395)	(2,366)
<i>Loans:</i>						
Loans	51,532	7,258	58,790	33,648	39	33,687
Loans exempt from federal income tax	2,170	110	2,280	237	(83)	154
Total loans	53,702	7,368	61,070	33,885	(44)	33,841
Loans held for sale	(504)	(44)	(548)	(982)	(41)	(1,023)
Nonmarketable equity securities	611	175	786	397	110	507
Total earning assets	\$ 61,069	\$ 8,589	\$ 69,658	\$ 36,294	\$ (4,318)	\$ 31,976
<b>INTEREST-BEARING LIABILITIES:</b>						
Checking and money market deposits	\$ 2,067	\$ 3,648	\$ 5,715	\$ 698	\$ 1,406	\$ 2,104
Savings deposits	316	74	390	107	7	114
Time deposits	1,760	1,805	3,565	252	—	252
Time, brokered deposits	(1,051)	1,303	252	457	269	726
Total interest-bearing deposits	3,092	6,830	9,922	1,514	1,682	3,196
Short-term borrowings	(93)	412	319	77	(1)	76
FHLB advances and other borrowings	3,505	3,248	6,753	1,970	1,567	3,537
Subordinated debt	1,984	18	2,002	331	(135)	196
Trust preferred debentures	233	600	833	239	212	451
Total interest-bearing liabilities	\$ 8,721	\$ 11,108	\$ 19,829	\$ 4,131	\$ 3,325	\$ 7,456
Net interest income	\$ 52,348	\$ (2,519)	\$ 49,829	\$ 32,163	\$ (7,643)	\$ 24,520

**Results of Operations – Comparison of Results of Operations for the Years Ended December 31, 2018 to December 31, 2017**

**Net Interest Income.** Our primary source of revenue is net interest income, which is the difference between interest income from interest-earning assets (primarily loans and securities) and interest expense of funding sources (primarily interest-bearing deposits and borrowings). Net interest income is impacted by the volume of interest-earning assets and related funding sources, as well as changes in the levels of interest rates. Noninterest-bearing sources of funds, such as demand deposits and shareholders' equity, also support earning assets. The net interest margin is calculated as net interest income divided by average interest-earning assets and is presented on a tax-equivalent basis, which means that tax-free interest income has been adjusted to a pretax-equivalent income, assuming a 21% tax rate in 2018 and a 35% tax rate in 2017.

The \$49.8 million, or 37.6%, increase in net interest income on a tax-equivalent basis was mainly due to a \$69.7 million increase in interest income on a tax-equivalent basis, offset in part by a \$19.8 million increase in interest expense. The increase in interest income was primarily due to the addition of loans from the Alpine acquisition. The increase in interest expense resulted in part from adding interest-bearing deposits, FHLB advances and trust preferred debentures from Alpine. Interest expense was also impacted by higher market interest rates and increased usage of FHLB advances as a funding source.

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**Interest Income.** The \$61.1 million, or 44.3%, increase on interest income on loans (on a tax-equivalent basis) for 2018 was primarily due to a 38.3% increase in the average balance of loans outstanding combined with a 21 basis point increase in the average yield. The increase in the average balance was primarily driven by the addition of loans from the Alpine and Centrué acquisitions combined with 3.9% of organic loan growth. The increase in the average yield was mainly due to a \$3.7 million increase in accretion income on loans and the impact of higher market interest rates.

The reported yield on total loans was 5.06% and 4.85% for 2018 and 2017, respectively. Accretion income associated with purchase accounting discounts established on loans acquired totaled \$13.4 million and \$9.7 million for 2018 and 2017, respectively, increasing the reported yields by 28 and 30 basis points for each respective period.

Interest income on our investment securities portfolio on a tax-equivalent basis increased \$7.1 million, or 57.0%, for the year ended December 31, 2018. This increase was primarily due to the impact of investment securities added from the Alpine and Centrué acquisitions.

Interest income on short-term cash investments increased to \$3.2 million in 2018 compared to \$2.0 million in 2017. This increase was primarily due to an increase in short-term interest rates.

**Interest Expense.** Interest expense on interest-bearing liabilities increased \$19.8 million, or 84.6%, to \$43.3 million in 2018 as compared to \$23.5 million in 2017 due to increases in interest expense on both deposits and borrowings.

Interest expense on deposits increased to \$22.1 million in 2018 compared to \$12.1 million in 2017. The \$9.9 million, or 81.8%, increase was primarily due to the average balance of deposits increasing 35.1% combined with a 19 basis point increase in the average rate paid. The increase in the average balance of deposits primarily reflected the addition of interest-bearing deposits from the Alpine and Centrué acquisitions. The increase in the average rate paid was primarily due to the impact of higher market interest rates.

Interest expense on borrowings increased \$9.9 million, or 87.5%, to \$21.2 million in 2018 as compared to \$11.3 million in 2017. This increase was primarily due to expanded usage of FHLB advances as a short- and long-term funding source, the addition of \$18.1 million of FHLB advances assumed from Alpine, the issuance of \$40.0 million of subordinated debt in October 2017 to assist with funding the acquisition of Alpine, and the impact of higher market interest rates on new FHLB advances and our variable rate trust preferred debentures. Interest expense on borrowings was also impacted by the full effect of FHLB advances, trust preferred debentures and a term loan assumed as a result of the Centrué acquisition.

**Provision for Loan Losses.** The provision for loan losses totaled \$9.4 million in 2018 compared to \$9.6 million in 2017. The provision in 2018 resulted primarily from specific reserves established on several commercial loans that were classified as nonaccrual during 2018 coupled with growth of our loan portfolio and the resultant increase in required reserves.

**Noninterest Income.** The following table sets forth the major components of our noninterest income for the years ended December 31, 2018 and 2017:

(dollars in thousands)	For the Year Ended		Increase (decrease)
	December 31,		
	2018	2017	
<i>Noninterest income:</i>			
Commercial FHA revenue	\$ 10,980	\$ 17,752	\$ (6,772)
Residential mortgage banking revenue	5,729	9,119	(3,390)
Wealth management revenue	20,513	13,340	7,173
Service charges on deposit accounts	10,440	5,975	4,465
Interchange revenue	10,674	5,353	5,321
Gain on sales of investment securities, net	464	222	242
Gain on sales of other real estate owned	544	145	399
Other income	12,447	7,456	4,991
Total noninterest income	\$ 71,791	\$ 59,362	\$ 12,429

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*Commercial FHA revenue.* The decrease of \$6.8 million in commercial FHA revenue resulted primarily from interest rate lock commitments declining from \$579.6 million during 2017 to \$236.6 million in 2018.

*Residential mortgage banking revenue.* Our residential mortgage banking revenue reflected declines in closed production and interest rate lock commitments that were due in part to a smaller loan production team.

*Wealth management revenue.* Noninterest income from our wealth management business increased primarily due to \$1.0 billion of assets under administration added from the acquisition of Alpine in the first quarter of 2018. The remaining increase in wealth management revenue reflected the impact of organic growth and a full year's effect of the assets added from the CedarPoint acquisition that closed late in the first quarter of 2017.

*Service charges on deposit accounts.* Noninterest income from service charges on deposit accounts was primarily due to the addition of transactional deposit accounts added from the Centrue and Alpine acquisitions.

*Interchange revenue.* Noninterest income from interchange revenue increased primarily due to an increased level of debit card activity related to the Centrue and Alpine acquisitions.

*Other noninterest income.* The increase in other noninterest income reflected increases in miscellaneous fees, bank-owned life insurance ("BOLI") and merchant services revenue related directly to the impact of the Alpine and Centrue acquisitions. Other income also included \$1.7 million of revenue related to a gain on proceeds from our BOLI program, recoveries of losses recorded on loans prior to the date of the Alpine acquisition and increases in bridge loan fees at Love Funding.

**Noninterest Expense.** The following table sets forth the major components of noninterest expense for the years ended December 31, 2018 and 2017:

(dollars in thousands)	For the Year Ended		Increase (decrease)
	December 31,		
	2018	2017	
<i>Noninterest expense:</i>			
Salaries and employee benefits	\$ 97,410	\$ 78,712	\$ 18,698
Occupancy and equipment	18,914	14,659	4,255
Data processing	26,062	15,171	10,891
FDIC insurance	2,209	1,806	403
Professional	12,782	14,359	(1,577)
Marketing	4,757	3,290	1,467
Communications	4,405	2,473	1,932
Loan expense	2,033	1,954	79
Other real estate owned	524	800	(276)
Amortization of intangible assets	6,956	3,325	3,631
Loss on mortgage servicing rights held for sale	458	4,059	(3,601)
Other expense	15,133	12,389	2,744
Total noninterest expense	<u>\$ 191,643</u>	<u>\$ 152,997</u>	<u>\$ 38,646</u>

*Salaries and employee benefits.* Salaries and employee benefits expense increased due to \$11.3 million of change in control payments, severance costs and other benefit-related expenses related to the Alpine acquisition. Salaries and employee benefits expense was also impacted by an increase in the number of full-time equivalent employees attributable to the Centrue and Alpine acquisitions.

*Occupancy and equipment.* Occupancy and equipment increased \$4.3 million primarily due to depreciation, real estate taxes, utilities, ongoing maintenance and lease obligations associated with branch and office facilities added from the Centrue and Alpine acquisitions.

*Data Processing.* The increase in data processing expense primarily resulted from the increased processing activity associated with the addition of Centrue and Alpine. Included in data processing was \$24.1 million of integration and acquisition expenses in 2018 associated primarily with Alpine.

*Professional.* Professional fees decreased \$1.6 million primarily due to a decrease in professional fees

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associated with the acquisition of Alpine as compared to the professional fees associated with the acquisition of Centruie in 2017.

*Marketing.* The increase in marketing expense reflected the impact of increased advertising and public relations expense centered on the promotion of our acquisition and integration of Alpine.

*Communications.* The increase in communications expense was mainly due to costs related to the Centruie and Alpine acquisitions.

*Amortization of intangible assets.* The increase in amortization of intangible assets expense was primarily due to amortization recorded on \$32.2 million of core deposit intangible established in conjunction with the Alpine and Centruie acquisitions and \$6.3 million in a customer relationship intangible established in conjunction with the Alpine acquisition.

*Loss on mortgage servicing rights held for sale.* In 2018, \$3.6 million of residential MSR was transferred to held for sale. A total loss of \$0.5 million was identified on MSR held for sale as compared to \$14.2 million of residential MSR transferred to held for sale and a loss of \$4.1 million recognized in 2017.

*Other noninterest expense.* The increase in other noninterest expense was primarily due to the Centruie and Alpine acquisitions and increases in costs associated with supplies, insurance, travel, meals, postage, and training.

*Income Tax Expense.* Income tax expense was \$11.4 million in 2018 compared to \$10.4 million in 2017. Effective tax rates for 2018 and 2017 were 22.4% and 39.3%, respectively. The maximum federal corporate income tax rate decreased from 35% to 21% beginning January 1, 2018. Our effective tax rate in 2017 was negatively impacted by the Company recording additional income tax expense of \$4.5 million for the revaluation of net deferred tax assets to account for reduced corporate tax rates starting in 2018.

## **Results of Operations—Comparison of Results of Operations for the Years Ended December 31, 2017 to December 31, 2016**

*Net Interest Income/Average Balance Sheet.* Net interest income on a tax-equivalent basis was \$132.4 million in 2017 compared to \$107.8 million in 2016. This increase was mainly due to a \$32.0 million increase in interest income on a tax-equivalent basis, offset in part by a \$7.5 million increase in interest expense. The increase in interest income was primarily due to the addition of loans from the Centruie acquisition. The increase in interest expense resulted in part from adding interest-bearing deposits, FHLB advances and trust preferred debentures from Centruie. Interest expense was also impacted by higher market interest rates and increased usage of FHLB advances as a funding source.

*Interest Income.* Total interest income on a tax-equivalent basis was \$155.8 million in 2017 compared to \$123.8 million in 2016. This increase was primarily attributable to increases in interest income on loans and cash investments, offset in part by decreases in interest income on investment securities and loans held for sale.

Interest income on loans on a tax-equivalent basis in 2017 was \$137.8 million compared to \$104.0 million in 2016. The \$33.8 million, or 32.5%, increase was primarily due to a 32.6% increase in the average balance of loans outstanding. This increase was primarily driven by the addition of \$679.9 million of loans from the Centruie acquisition combined with organic loan growth of 9.8%.

The average rate on loans benefits from purchase accounting discount accretion on loan portfolios acquired (see “*Primary Factors Affecting Comparability – PCI Loans*” above). The reported yield on total loans was 4.85% for both 2017 and 2016. Accretion income associated with purchase accounting discounts established on loans acquired totaled \$9.7 million and \$11.7 million for 2017 and 2016, respectively, increasing the reported yields by 30 and 48 basis points for each respective period. The reduced effect of accretion income on our 2017 reported yield was offset by the favorable impact of higher market interest rates in 2017.

Interest income on our investment securities portfolio on a tax-equivalent basis decreased \$2.4 million, or 15.9%, to \$12.5 million in 2017 compared to \$14.9 million in 2016. This decrease was mainly attributable to a decline in the average yield on investment securities of 155 basis points, offset in part by an increase in the average balance of investment securities of 27.4%. The decrease in the average yield resulted primarily from the impact of selling in the

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fourth quarter of 2016. \$72.1 million of previously covered mortgage-backed securities CMOs that were yielding approximately 13.0% (see “*Primary Factors Affecting Comparability – Sale of Previously Covered Non-Agency Mortgage-Backed Securities*” above), coupled with lower yields being earned on Centrue’s investment portfolio. The increase in the average balance was primarily due to the addition of \$149.0 million of investment securities from Centrue.

Interest income on short-term cash investments increased to \$2.0 million in 2017 compared to \$0.9 million in 2016. This increase was primarily due to an increase in short-term interest rates.

*Interest Expense.* Interest expense on interest-bearing liabilities increased \$7.5 million, or 46.6%, to \$23.5 million in 2017 as compared to \$16.0 million in 2016 due to increases in interest expense on both deposits and borrowings.

Interest expense on deposits increased to \$12.1 million in 2017 compared to \$8.9 million in 2016. The \$3.2 million, or 35.8%, increase was primarily due to the average balance of deposits increasing 22.7% combined with a five basis point increase in the average rate paid. The increase in the average balance of deposits primarily reflected the addition of \$583.7 million of interest-bearing deposits from Centrue. The increase in the average rate paid was primarily due to the impact of higher market interest rates.

Interest expense on borrowings increased \$4.3 million, or 60.3%, to \$11.3 million in 2017 as compared to \$7.1 million in 2016. This increase primarily consisted of increased interest expense on FHLB advances and other borrowings, subordinated debt and trust preferred debentures of \$3.5 million, \$0.2 million and \$0.5 million respectively. These increases were primarily due to expanded usage of FHLB advances as a short- and long-term funding source, the addition of \$95.0 million of FHLB advances and \$10.0 million of trust preferred debentures from Centrue, entering into a \$40.0 million term loan in May 2017, issuing \$40.0 million of subordinated debt in October 2017 and the impact of higher market interest rates on new FHLB advances and our variable rate trust preferred debentures.

*Provision for Loan Losses.* The provision for loan losses totaled \$9.6 million in 2017 compared to \$5.6 million in 2016. The \$4.0 million increase in the provision resulted primarily from an increase in net charge-offs for 2017 combined with the growth of our loan portfolio. During the fourth quarter of 2017, we recorded \$6.5 million of net charge-offs which were largely related to deterioration in our collateral position on two commercial real estate loans.

**Noninterest Income.** The following table sets forth the major components of our noninterest income for the years ended December 31, 2017 and 2016:

(dollars in thousands)	For the Year Ended December 31,		Increase (decrease)
	2017	2016	
<i>Noninterest income:</i>			
Commercial FHA revenue	\$ 17,752	\$ 22,064	\$ (4,312)
Residential mortgage banking revenue	9,119	13,389	(4,270)
Wealth management revenue	13,340	8,091	5,249
Service charges on deposit accounts	5,975	3,904	2,071
Interchange revenue	5,353	3,750	1,603
FDIC loss-sharing expense	—	(1,661)	1,661
Gain on sales of investment securities, net	222	14,702	(14,480)
Other-than-temporary impairment on investment securities	—	(824)	824
Gain on sales of other real estate owned	145	113	32
Other income	7,456	8,529	(1,073)
Total noninterest income	<u>\$ 59,362</u>	<u>\$ 72,057</u>	<u>\$ (12,695)</u>

*Commercial FHA revenue.* Our commercial FHA business generated gains on loans held for sale of \$17.3 million and net servicing revenues of \$0.4 million in 2017 compared to gains on loans held for sale of \$21.7 million and net servicing revenues of \$0.4 million in 2016. The \$4.3 million decrease in gains on loans held for sale resulted primarily from a decrease in commercial FHA interest rate lock commitments to \$579.6 million in 2017 compared to \$740.8 million in 2016. Net servicing revenue in 2017 and 2016 included MSR impairment of \$1.5 million and \$1.7 million, respectively.

*Residential mortgage banking revenue.* Our residential mortgage banking activities generated gains on loans held for sale of \$7.0 million and net servicing revenue of \$2.1 million in 2017 compared to gains on loans held for sale of \$13.5 million and a net servicing loss of \$0.1 million in 2016. The \$6.5 million decrease in gains on loans held for sale was primarily due to a 37.8% decrease in interest rate lock commitments during 2017. The \$2.2 million increase in net servicing revenue primarily resulted from a \$0.6 million decrease in impairment recorded against our residential mortgage servicing rights combined with a \$1.2 million decrease in MSR amortization due to the classification of all Fannie Mae residential mortgage servicing as held for sale in the third quarter and the discontinuance of amortization thereon (see “*Primary Factors Affecting Comparability – Mortgage Servicing Rights*” above).

*Wealth management revenue.* Noninterest income from our wealth management business increased \$5.2 million, or 64.9%, to \$13.3 million in 2017. The increase in wealth management revenue was primarily due to 73.5% growth in assets under administration since the end of 2015. The increase in assets under administration consisted of approximately \$400.0 million of wealth management assets added from the Sterling acquisition that closed in November 2016, \$180.0 million of assets under administration added from the CedarPoint acquisition that closed in March 2017 and organic growth experienced over the past two years.

*Service charges on deposit accounts.* Noninterest income from service charges on deposit accounts totaled \$6.0 million in 2017 compared to \$3.9 million in 2016. This 53.0% increase primarily resulted from the addition of transactional deposit accounts associated with the Centru acquisition that closed in June 2017.

*Interchange revenue.* Noninterest income from interchange revenue totaled \$5.4 million in 2017 compared to \$3.8 million in 2016. This 42.7% increase was primarily due to an increased level of debit card activity resulting from the Centru acquisition that closed in June 2017.

*FDIC loss-sharing expense.* In October 2016, we entered into an agreement with the FDIC to terminate the remaining provisions of the then existing loss-share agreements. As a result, we recorded no FDIC loss-sharing expense during 2017. FDIC loss-sharing expense in 2016 consisted primarily of a \$1.5 million reimbursement to the FDIC for 80% of covered losses paid to us previously on a covered loan that was paid in full during the second quarter of 2016 (see “*Primary Factors Affecting Comparability – PCI Loans*” above).



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*Gain on sales of investment securities, net.* Gains recognized on sales of investment securities totaled \$0.2 million in 2017 compared to \$14.7 million in 2016. This decrease primarily resulted from the October 2016 sale of previously covered non-agency mortgage-backed securities with a carrying value of \$72.1 million. As a result of the sale, we recognized a gain totaling \$14.3 million in the fourth quarter of 2016.

*Other-than-temporary impairment on investment securities.* During the first quarter of 2016, we recognized other-than-temporary impairment (“OTTI”) losses of \$0.8 million due to changes in expected cash flows on three previously covered CMOs. Early in the fourth quarter of 2016, all previously covered CMOs totaling \$72.1 million were sold. We recorded no OTTI losses in 2017.

*Other income.* Other income totaled \$7.5 million in 2017 compared to \$8.6 million in 2016. During 2016, we recognized a \$0.7 million gain on proceeds of death benefits due to the passing of an employee covered by BOLI. Additionally, other noninterest income in 2016 was favorably impacted by the reversal of a \$0.4 million contingent consideration accrual associated with the Heartland Bank acquisition that closed in December 2014. The Company concluded during the second quarter of 2016 that Love Funding would not reach the level of net income for the two-year period ending December 31, 2016 that would trigger a contingent consideration payment.

**Noninterest Expense.** The following table sets forth the major components of our noninterest expense for the years ended December 31, 2017 and 2016:

(dollars in thousands)	For the Year Ended December 31,		Increase (decrease)
	2017	2016	
<i>Noninterest expense:</i>			
Salaries and employee benefits	\$ 78,712	\$ 66,293	\$ 12,419
Occupancy and equipment	14,659	13,080	1,579
Data processing	15,171	10,658	4,513
FDIC insurance	1,806	1,707	99
Professional	14,359	8,049	6,310
Marketing	3,290	2,733	557
Communications	2,473	2,150	323
Loan expense	1,954	1,957	(3)
Other real estate owned	800	935	(135)
Amortization of intangible assets	3,325	2,147	1,178
Loss on mortgage servicing rights held for sale	4,059	—	4,059
Other	12,389	11,580	809
Total noninterest expense	<u>\$ 152,997</u>	<u>\$ 121,289</u>	<u>\$ 31,708</u>

*Salaries and employee benefits.* Salaries and employee benefits expense increased \$12.4 million, or 18.7%, to \$78.7 million in 2017. This increase was directly impacted by acquisition-related costs associated with the Centruie acquisition of \$7.1 million in 2017. For Centruie, we recorded \$4.3 million of change in control costs, along with severance and other benefit related expenses. Salaries and employees benefits expense was also impacted by an increase in the number of full-time equivalent employees attributable primarily to the Centruie transaction, annual salary increases that took effect in 2017 and increased benefit costs.

*Occupancy and equipment.* Occupancy equipment expense increased \$1.6 million, or 12.1%, to \$14.7 million in 2017. This increase was mainly due to depreciation, real estate taxes, utilities, ongoing maintenance and lease obligations associated with the branch and office facilities added from the Centruie acquisition.

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*Data processing.* Data processing expense increased \$4.5 million, or 42.3%, to \$15.2 million in 2017. This increase resulted primarily from one-time data processing costs incurred in conjunction with the conversion of Centruie's systems to the core processing platform and ancillary systems used by the Company, combined with increased processing costs related to the addition of Centruie and growth of our wealth management business. Data processing expense also includes a \$1.8 million fee paid in July 2017 to terminate the contract with Centruie's debit card service provider.

*Professional.* Professional fees increased \$6.3 million, or 78.4%, to \$14.4 million in 2017. This increase resulted primarily from acquisition-related expenses associated with the Centruie acquisition coupled with professional fees incurred on various technology and other integration projects.

*Marketing.* Marketing expense increased \$0.6 million, or 20.4%, to \$3.3 million in 2017. This increase reflected the impact of increased advertising and public relations expense centered on the promotion of our acquisition and integration of Centruie.

*Amortization of intangible assets.* Amortization of intangible assets was \$3.3 million in 2017 compared to \$2.1 million in 2016. This increase was primarily due to amortization recorded on the \$11.1 million core deposit intangible established in conjunction with the Centruie acquisition in June 2017.

*Loss on mortgage servicing rights held for sale.* During the third quarter of 2017, we committed to a plan to sell our Fannie Mae residential mortgage servicing and transferred \$14.2 million of residential MSR, net of valuation allowances, to MSR held for sale (see "Primary Factors Affecting Comparability – Mortgage Servicing Rights" above). As a result, we recognized a \$4.1 million loss on MSR held for sale to reflect them at the lower of their carrying amount or fair value less costs to sell. After recognizing this loss, MSR held for sale had a net carrying value of \$10.2 million at December 31, 2017.

*Other expense.* Other expense totaled \$12.4 million in 2017 compared to \$11.6 million in 2016. This increase was primarily attributable to the Centruie acquisition and increases in costs associated with supplies, insurance, travel, meals, postage, and training. Included in other noninterest expense for 2017 was \$2.0 million of asset impairment on banking facilities that were closed during 2017.

*Income Tax Expense.* Income tax expense was \$10.4 million in 2017 compared to \$18.9 million in 2016. Effective tax rates for 2017 and 2016 were 39.3% and 37.5%, respectively. Our effective tax rate in 2017 was negatively impacted by the Company recording additional income tax expense of \$4.5 million for the revaluation of net deferred tax assets to account for reduced corporate tax rates starting in 2018. In 2016, our effective tax rate was adversely affected by the write-off of state tax refunds and tax credits obtained through the Heartland acquisition.

## **Financial Condition**

*Assets.* Total assets increased \$1.22 billion to \$5.64 billion at December 31, 2018 as compared to December 31, 2017. This increase primarily reflected the addition of \$1.24 billion of assets from the Alpine acquisition.

*Loans.* The loan portfolio is the largest category of our assets. At December 31, 2018, total loans, net of allowance for loan losses, were \$4.12 billion. The following table presents the balance and associated percentage of each major category in our loan portfolio at December 31, 2018, 2017, 2016, 2015 and 2014:

(dollars in thousands)	As of December 31,									
	2018		2017		2016		2015		2014	
	Book Value	%	Book Value	%	Book Value	%	Book Value	%	Book Value	%
Loans:										
Commercial	\$ 810,884	19.6 %	\$ 555,930	17.2 %	\$ 457,827	19.7 %	\$ 499,573	25.0 %	\$ 467,349	26.0 %
Commercial real estate	1,639,155	39.6	1,440,011	44.6	969,615	41.8	876,784	43.9	786,665	43.7
Construction and land development	232,229	5.6	200,587	6.2	177,325	7.7	150,266	7.6	136,985	7.6
Total commercial loans	2,682,268		2,196,528		1,604,767		1,526,623		1,390,999	
Residential real estate	578,048	14.0	453,552	14.1	253,713	10.9	163,224	8.2	172,075	9.6
Consumer	613,184	14.8	371,455	11.5	270,017	11.6	161,512	8.1	120,434	6.7
Lease financing	264,051	6.4	205,143	6.4	191,479	8.3	144,230	7.2	114,507	6.4
Total loans, gross	4,137,551		3,226,678		2,319,976		1,995,589		1,798,015	
Allowance for loan losses	(20,903)	0.5	(16,431)	0.5	(14,862)	0.6	(15,988)	0.8	(12,300)	0.7
Total loans, net	\$ 4,116,648		\$ 3,210,247		\$ 2,305,114		\$ 1,979,601		\$ 1,785,715	
Covered loans	\$ —	—	\$ —	—	\$ —	—	\$ 3,629	0.2	\$ 6,849	0.4
PCI loans	42,975	1.0	22,461	0.7	28,256	1.2	38,477	1.9	44,201	2.5

Total loans increased \$910.9 million to \$4.12 billion at December 31, 2018 as compared to December 31, 2017. The increase in loans was primarily due to \$786.2 million of loans added from the Alpine acquisition. The remaining increase primarily resulted from organic growth of our equipment financing business and consumer loans. The \$20.5 million increase in PCI loans at December 31, 2018 compared to December 31, 2017 reflected the addition of \$35.0 million of PCI loans from the Alpine acquisition, partially offset by loan payoffs and repayments.

Outstanding loan balances increased due to new loan originations, advances on outstanding commitments and loans acquired as a result of acquisitions of other financial institutions, net of amounts received for loan payments and payoffs, charge-offs of loans and transfers of loans to other real estate owned. The following table shows the fair values of those loans acquired at acquisition date and the net growth for the periods presented.

(dollars in thousands)	For the Year Ended December 31,					
	2018		2017		2016	
	Acquired	Net Growth (Attrition)	Acquired	Net Growth (Attrition)	Acquired	Net Growth (Attrition)
Commercial	\$ 198,866	\$ 56,088	\$ 104,812	\$ (6,709)	\$ —	\$ (41,746)
Commercial real estate	347,360	(148,216)	484,772	(14,376)	—	92,831
Construction and land development	44,856	(13,214)	28,458	(5,196)	—	27,059
Total commercial loans	591,082	(105,342)	618,042	(26,281)	—	78,144
Residential real estate	120,645	3,851	58,857	140,982	—	90,489
Consumer	74,459	167,270	3,047	98,391	—	108,505
Lease financing	—	58,908	—	13,664	—	47,249
Total loans	\$ 786,186	\$ 124,687	\$ 679,946	\$ 226,756	\$ —	\$ 324,387

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The principal categories of our loan portfolio are discussed below:

*Commercial loans.* We provide a mix of variable and fixed rate commercial loans. The loans are typically made to small- and medium-sized manufacturing, wholesale, retail and service businesses for working capital needs, business expansions and farm operations. Commercial loans generally include lines of credit and loans with maturities of five years or less. The loans are generally made with business operations as the primary source of repayment, but may also include collateralization by inventory, accounts receivable and equipment, and generally include personal guarantees.

*Commercial real estate loans.* Our commercial real estate loans consist of both real estate occupied by the borrower for ongoing operations and non-owner occupied real estate properties. The real estate securing our existing commercial real estate loans includes a wide variety of property types, such as owner occupied offices, warehouses and production facilities, office buildings, hotels, mixed-use residential and commercial facilities, retail centers, multifamily properties and assisted living facilities. Our commercial real estate loan portfolio also includes farmland loans. Farmland loans are generally made to a borrower actively involved in farming rather than to passive investors.

*Construction and land development loans.* Our construction and land development loans are comprised of residential construction, commercial construction and land acquisition and development loans. Interest reserves are generally established on real estate construction loans.

*Residential real estate loans.* Our residential real estate loans consist of residential properties that generally do not qualify for secondary market sale.

*Consumer loans.* Our consumer loans include direct personal loans, indirect automobile loans, lines of credit and installment loans originated through home improvement specialty retailers and contractors. Personal loans are generally secured by automobiles, boats and other types of personal property and are made on an installment basis.

*Lease financing.* Our equipment leasing business provides financing leases to varying types of businesses, nationwide, for purchases of business equipment and software. The financing is secured by a first priority interest in the financed asset and generally requires monthly payments.

(dollars in thousands)	December 31, 2018			December 31, 2017			December 31, 2016		
	Non-PCI Loans	PCI Loans	Total	Non-PCI Loans	PCI Loans	Total	Non-PCI Loans	PCI Loans	Total
Loans:									
Commercial	\$ 806,027	\$ 4,857	\$ 810,884	\$ 553,257	\$ 2,673	\$ 555,930	\$ 454,310	\$ 3,517	\$ 457,827
Commercial real estate	1,619,903	19,252	1,639,155	1,427,076	12,935	1,440,011	963,895	5,720	969,615
Construction and land development	223,898	8,331	232,229	199,853	734	200,587	165,175	12,150	177,325
Total commercial loans	2,649,828	32,440	2,682,268	2,180,186	16,342	2,196,528	1,583,380	21,387	1,604,767
Residential real estate	569,289	8,759	578,048	447,602	5,950	453,552	247,156	6,557	253,713
Consumer	611,408	1,776	613,184	371,286	169	371,455	269,705	312	270,017
Lease financing	264,051	—	264,051	205,143	—	205,143	191,479	—	191,479
Total loans, gross	4,094,576	42,975	4,137,551	3,204,217	22,461	3,226,678	2,291,720	28,256	2,319,976
Allowance for loan losses	(19,335)	(1,568)	(20,903)	(14,902)	(1,529)	(16,431)	(13,744)	(1,118)	(14,862)
Total loans, net	\$ 4,075,241	\$ 41,407	\$ 4,116,648	\$ 3,189,315	\$ 20,932	\$ 3,210,247	\$ 2,277,976	\$ 27,138	\$ 2,305,114

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The following table shows the contractual maturities of our loan portfolio and the distribution between fixed and adjustable interest rate loans at December 31, 2018:

(dollars in thousands)	December 31, 2018						Total
	Within One Year		One Year to Five Years		After Five Years		
	Fixed Rate	Adjustable Rate	Fixed Rate	Adjustable Rate	Fixed Rate	Adjustable Rate	
Loans:							
Commercial	\$ 47,364	\$ 293,120	\$ 241,301	\$ 73,890	\$ 115,264	\$ 39,945	\$ 810,884
Commercial real estate	198,350	86,106	820,690	204,596	62,162	267,251	1,639,155
Construction and land development	15,362	67,322	46,679	98,498	237	4,131	232,229
Total commercial loans	261,076	446,548	1,108,670	376,984	177,663	311,327	2,682,268
Residential real estate	4,382	9,372	25,069	43,276	198,995	296,954	578,048
Consumer	3,649	2,593	585,536	20,161	1,207	38	613,184
Lease financing	7,816	—	237,060	—	19,175	—	264,051
Total loans	\$ 276,923	\$ 458,513	\$ 1,956,335	\$ 440,421	\$ 397,040	\$ 608,319	\$ 4,137,551

### Loan Quality

We use what we believe is a comprehensive methodology to monitor credit quality and prudently manage credit concentration within our loan portfolio. Our underwriting policies and practices govern the risk profile and credit and geographic concentration for our loan portfolio. We also have what we believe to be a comprehensive methodology to monitor these credit quality standards, including a risk classification system that identifies potential problem loans based on risk characteristics by loan type as well as the early identification of deterioration at the individual loan level. In addition to our allowance for loan losses, our purchase discounts on acquired loans provide additional protections against credit losses.

*Discounts on PCI Loans.* PCI loans are loans that have evidence of credit deterioration since origination and for which it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments. These loans are recorded at estimated fair value on their purchase date without a carryover of the related allowance for loan losses. At December 31, 2018 and 2017, we had PCI loans totaling \$43.0 million and \$22.5 million, respectively.

In determining the fair value of purchased credit impaired loans at acquisition, we first determine the contractually required payments due, which represent the total undiscounted amount of all uncollected principal and interest payments, adjusted for the effect of estimated prepayments. We then estimate the undiscounted cash flows we expect to collect. We incorporate several key assumptions to estimate cash flows expected to be collected, including probability of default rates, loss given default assumptions and the amount and timing of prepayments. We calculate fair value by discounting the estimated cash flows we expect to collect using an observable market rate of interest, when available, adjusted for factors that a market participant would consider in determining fair value. We have aggregated certain credit-impaired loans acquired in the same transaction into pools based on common risk characteristics. A pool is accounted for as one asset with a single composite interest rate and an aggregate fair value and expected cash flows.

The difference between contractually required payments due and the cash flows expected to be collected, considering the impact of prepayments, is referred to as the nonaccretable difference. The nonaccretable difference, which is neither accreted into income nor recorded on our consolidated balance sheet, reflects estimated future credit losses expected to be incurred over the life of the loans. The excess of cash flows expected to be collected over the estimated fair value of PCI loans is referred to as the accretable yield. This amount is not recorded on our consolidated balance sheet, but is accreted into interest income over the remaining life of the loans, or pool of loans, using the effective yield method. The outstanding customer balance for PCI loans totaled \$56.9 million and \$32.8 million as of December 31, 2018 and 2017, respectively.

Subsequent to an acquisition, we periodically evaluate our estimates of cash flows expected to be collected. These evaluations, performed quarterly, require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and nonaccretable difference or reclassifications between accretable yield and the nonaccretable difference. Decreases in expected cash flows due to further credit deterioration will result in an impairment charge to the provision for loan losses, resulting in an increase to the allowance for loan losses and a reclassification from accretable

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yield to nonaccretable difference. Increases in expected cash flows due to credit improvements will result in an increase in the accretible yield through a reclassification from the nonaccretable difference or as a reduction in the allowance for loan losses to the extent established on specific pools subsequent to acquisition. The adjusted accretible yield is recognized in interest income over the remaining life of the loan, or pool of loans.

The following table shows changes in the accretible yield for PCI loans for the years ended December 31, 2018, 2017 and 2016:

(dollars in thousands)	For the Year Ended December 31,		
	2018	2017	2016
Balance, beginning of period	\$ 5,732	\$ 9,035	\$ 10,526
New loans purchased – Alpine acquisition	6,095	—	—
New loans purchased – Centruac acquisition	—	1,929	—
Accretion	(6,092)	(5,546)	(8,579)
Other adjustments (including maturities, charge-offs and impact of changes in timing of expected cash flows)	2,682	120	915
Reclassification from non-accretable	3,823	194	6,173
Balance, end of period	\$ 12,240	\$ 5,732	\$ 9,035

As of December 31, 2018, the balance of accretible discounts on our PCI loan portfolio was \$12.2 million compared to \$5.7 million at December 31, 2017. We may not accrete the full amount of these discounts into interest income in future periods if the assets to which these discounts are applied do not perform according to our current expectations.

We have also recorded accretible discounts in purchase accounting for loans that are not considered PCI loans. Similar to the way in which we employ the fair value methodology for PCI loans, we consider expected prepayments and estimate the amount and timing of undiscounted cash flows in order to determine the accretible discount for non-PCI loans.

*Analysis of the Allowance for Loan Losses.* The following table allocates the allowance for loan losses, or the allowance, by loan category:

(dollars in thousands)	As of December 31,									
	2018		2017		2016		2015		2014	
	Book Value	% <sup>(1)</sup>	Book Value	% <sup>(1)</sup>	Book Value	% <sup>(1)</sup>	Book Value	% <sup>(1)</sup>	Book Value	% <sup>(1)</sup>
Loans:										
Commercial	\$ 9,524	1.17 %	\$ 5,256	0.95 %	\$ 5,920	1.29 %	\$ 6,917	1.38 %	\$ 2,284	0.49 %
Commercial real estate	4,723	0.29	5,044	0.35	3,225	0.33	5,179	0.59	6,925	0.88
Construction and land development	372	0.16	518	0.26	345	0.19	435	0.29	486	0.35
Total commercial loans	14,619	0.55	10,818	0.49	9,490	0.59	12,531	0.82	9,695	0.70
Residential real estate	2,041	0.35	2,750	0.61	2,929	1.15	2,120	1.30	2,038	1.18
Consumer	2,154	0.35	1,344	0.36	930	0.34	749	0.46	567	0.47
Lease financing	2,089	0.79	1,519	0.74	1,513	0.79	588	0.41	—	0.00
Total allowance for loan losses	\$ 20,903	0.51	\$ 16,431	0.51	\$ 14,862	0.64	\$ 15,988	0.80	\$ 12,300	0.69

(1) Represents the percentage of the allowance to total loans in the respective category.

The allowance and the balance of nonaccretable discounts represent our estimate of probable and reasonably estimable credit losses inherent in loans held for investment as of the respective balance sheet date. We assess the appropriateness of our allowance for non-PCI loans separately from our allowance for PCI loans.

The allowance for loan losses was \$20.9 million at December 31, 2018 compared to \$16.4 million at December 31, 2017. The \$4.5 million increase in the allowance was mainly attributable to a \$4.2 million increase in specific reserves related primarily to commercial loans that were classified as nonaccrual during 2018.

Individual loans considered to be uncollectible are charged off against the allowance. Factors used in determining the amount and timing of charge-offs on loans include consideration of the loan type, length of delinquency,

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sufficiency of collateral value, lien priority and the overall financial condition of the borrower. Collateral value is determined using updated appraisals and/or other market comparable information. Charge-offs are generally taken on loans once the impairment is determined to be other-than-temporary. Recoveries on loans previously charged off are added to the allowance. Net charge-offs to average loans were 0.13% and 0.28% for 2018 and 2017, respectively.

*Allowance for non-PCI loans.* Our methodology for assessing the appropriateness of the allowance for non-PCI loans includes a general allowance for performing loans, which are grouped based on similar characteristics, and a specific allowance for individual impaired loans or loans considered by management to be in a high risk category. General allowances are established based on a number of factors, including historical loss rates, an assessment of portfolio trends and conditions, accrual status and economic conditions.

For commercial, commercial real estate and construction and land development loans, a specific allowance may be assigned to individual loans based on an impairment analysis. Loans are considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. The amount of impairment is based on an analysis of the most probable source of repayment, including the present value of the loan's expected future cash flows and the estimated market value or the fair value of the underlying collateral. Interest income on impaired loans is accrued as earned, unless the loan is placed on nonaccrual status.

*Allowance for PCI loans.* PCI loans are recorded at their estimated fair value at the date of acquisition, with the estimated fair value including a component for estimated credit losses. An allowance related to PCI loans may be recorded subsequent to acquisition if a PCI loan pool experiences a decrease in expected cash flows as compared to the expected cash flows projected in the previous quarter. Loans considered to be uncollectible are initially charged off against the specific loan pool's non-accretable difference. When the pool's non-accretable difference has been fully utilized, uncollectible amounts are charged off against the corresponding allowance. The following table shows our allowance by loan portfolio and by non-PCI and PCI loans as of December 31, 2018, 2017 and 2016:

(dollars in thousands)	December 31, 2018			December 31, 2017			December 31, 2016		
	Non-PCI Loans	PCI Loans	Total	Non-PCI Loans	PCI Loans	Total	Non-PCI Loans	PCI Loans	Total
Loans:									
Commercial	\$ 9,419	\$ 105	\$ 9,524	\$ 4,756	\$ 500	\$ 5,256	\$ 5,421	\$ 499	\$ 5,920
Commercial real estate	3,879	844	4,723	4,708	336	5,044	2,993	232	3,225
Construction and land development	372	—	372	514	4	518	345	—	345
Total commercial loans	13,670	949	14,619	9,978	840	10,818	8,759	731	9,490
Residential real estate	1,605	436	2,041	2,210	540	2,750	2,572	357	2,929
Consumer	1,971	183	2,154	1,195	149	1,344	900	30	930
Lease financing	2,089	—	2,089	1,519	—	1,519	1,513	—	1,513
Total allowance for loan losses	\$ 19,335	\$ 1,568	\$ 20,903	\$ 14,902	\$ 1,529	\$ 16,431	\$ 13,744	\$ 1,118	\$ 14,862

*Provision for Loan Losses.* In determining the allowance and the related provision for loan losses, we consider three principal elements: (i) valuation allowances based upon probable losses identified during the review of impaired commercial, commercial real estate, and construction and land development loans, (ii) allocations, by loan classes, on loan portfolios based on historical loan loss experience and qualitative factors, and (iii) valuation allowances on PCI loan pools based on decreases in expected cash flows. Provisions for loan losses are charged to operations to adjust the total allowance to a level deemed appropriate by us.

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The following table provides an analysis of the allowance for loan losses, provision for loan losses and net charge-offs for the years indicated:

(dollars in thousands)	As of and for the Year Ended December 31,				
	2018	2017	2016	2015	2014
Balance, beginning of period	\$ 16,431	\$ 14,862	\$ 15,988	\$ 12,300	\$ 23,672
Charge-offs:					
Commercial	1,236	737	4,252	7,742	153
Commercial real estate	492	6,552	1,177	379	11,120
Construction and land development	—	—	1	171	62
Residential real estate	361	698	966	742	569
Consumer	1,876	794	301	334	192
Lease financing	3,024	1,041	1,039	289	—
Total charge-offs	6,989	9,822	7,736	9,657	12,096
Recoveries:					
Commercial	563	191	263	1,221	68
Commercial real estate	378	492	264	634	374
Construction and land development	81	63	94	34	12
Residential real estate	169	518	174	161	100
Consumer	530	254	100	111	78
Lease financing	310	317	124	57	—
Total recoveries	2,031	1,835	1,019	2,218	632
Net charge-offs	4,958	7,987	6,717	7,439	11,464
Provision for loan losses	9,430	9,556	5,591	11,127	92
Balance, end of period	\$ 20,903	\$ 16,431	\$ 14,862	\$ 15,988	\$ 12,300
Gross loans, end of period	\$ 4,137,551	\$ 3,226,678	\$ 2,319,976	\$ 1,995,589	\$ 1,798,015
Average total loans	\$ 3,929,074	\$ 2,841,604	\$ 2,143,787	\$ 1,901,516	\$ 1,218,141
Net charge-offs to average loans	0.13 %	0.28 %	0.31 %	0.39 %	0.94 %
Allowance to total loans	0.51 %	0.51 %	0.64 %	0.80 %	0.69 %

**Impaired Loans.** The following table sets forth our nonperforming assets by asset categories as of the dates indicated. Impaired loans include nonaccrual loans, loans past due 90 days or more and still accruing interest and loans modified under troubled debt restructurings. The balances of impaired loans reflect the net investment in these assets, including deductions for purchase discounts. PCI loans are excluded from nonperforming status because we expect to fully collect their new carrying values, which reflect significant purchase discounts. If our expectation of reasonably estimable future cash flows from PCI loans deteriorates, the loans may be classified as nonaccrual loans and interest income will not be recognized until the timing and amount of future cash flows can be reasonably estimated.

(dollars in thousands)	As of December 31,				
	2018	2017	2016	2015	2014
Impaired loans:					
Commercial	\$ 8,928	\$ 4,103	\$ 6,548	\$ 6,570	\$ 14,303
Commercial real estate	23,868	13,997	18,398	13,717	14,186
Construction and land development	1,307	843	84	—	127
Residential real estate	7,270	6,184	5,029	4,155	3,272
Consumer	569	287	213	51	48
Lease financing	957	1,346	1,331	398	236
Total impaired loans	42,899	26,760	31,603	24,891	32,172
Other real estate owned, non-covered/non-guaranteed	3,000	4,134	2,947	4,315	7,370
Nonperforming assets	\$ 45,899	\$ 30,894	\$ 34,550	\$ 29,206	\$ 39,542
Impaired loans to total loans	1.04 %	0.83 %	1.36 %	1.25 %	1.80 %
Nonperforming assets to total assets	0.81 %	0.70 %	1.07 %	1.01 %	1.48 %

We did not recognize any interest income on nonaccrual loans during the years ended December 31, 2018, 2017 and 2016 while they were in nonaccrual status. Additional interest income that we would have recognized on these loans had they been current in accordance with their original terms was \$1.8 million, \$0.9 million and \$0.7 million during the years ended December 31, 2018, 2017 and 2016, respectively. We recognized interest income on commercial and commercial real estate loans modified under troubled debt restructurings of \$0.1 million, \$0.1 million and \$0.3 million during the years ended December 31, 2018, 2017 and 2016, respectively.



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We utilize an asset risk classification system in compliance with guidelines established by the Federal Reserve as part of our efforts to improve asset quality. In connection with examinations of insured institutions, examiners have the authority to identify problem assets and, if appropriate, classify them. There are three classifications for problem assets: "substandard," "doubtful," and "loss." Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full questionable and there is a high probability of loss based on currently existing facts, conditions and values. An asset classified as loss is not considered collectable and is of such little value that continuance as an asset is not warranted.

We use a ten grade risk rating system to categorize and determine the credit risk of our loans. Potential problem loans include loans with a risk grade of 7, which are "special mention," and loans with a risk grade of 8, which are "substandard" loans that are not considered to be impaired. These loans generally require more frequent loan officer contact and receipt of financial data to closely monitor borrower performance. Potential problem loans are managed and monitored regularly through a number of processes, procedures and committees, including oversight by a loan administration committee comprised of executive officers and other members of the Bank's senior management team.

The following table presents the recorded investment of potential problem commercial loans (excluding PCI loans) by loan category at the dates indicated:

(dollars in thousands)	Commercial		Commercial Real Estate		Construction & Land Development		Total
	Risk Category		Risk Category		Risk Category		
	7	8 <sup>(1)</sup>	7	8 <sup>(1)</sup>	7	8 <sup>(1)</sup>	
December 31, 2018	\$ 34,857	\$ 12,956	\$ 14,934	\$ 45,263	\$ 3,448	\$ —	\$ 111,458
December 31, 2017	12,588	\$ 27,419	\$ 12,260	\$ 14,770	\$ —	\$ —	\$ 67,037
December 31, 2016	10,930	12,037	8,735	11,039	—	450	43,191
December 31, 2015	15,884	3,370	23,679	8,103	540	—	51,576
December 31, 2014	2,233	2,266	9,281	13,134	451	—	27,365

(1) Includes only those 8-rated loans that are not included in nonperforming loans.

**Investment Securities.** Our investment strategy aims to maximize earnings while maintaining liquidity in securities with minimal credit risk. The types and maturities of securities purchased are primarily based on our current and projected liquidity and interest rate sensitivity positions.

The following table sets forth the book value and percentage of each category of investment securities at December 31, 2018, 2017 and 2016. The book value for investment securities classified as available for sale is equal to fair market value and the book value for investment securities classified as held to maturity is equal to amortized cost.

(dollars in thousands)	December 31,					
	2018		2017		2016	
	Book Value	% of Total	Book Value	% of Total	Book Value	% of Total
<i>Investment securities, available for sale, at fair value</i>						
U.S. Treasury securities	\$ 24,650	3.7 %	\$ 27,718	6.1 %	\$ 75,901	23.3 %
Government sponsored entity debt securities	75,684	11.5	25,211	5.6	7,688	2.4
Agency mortgage-backed securities	326,305	49.4	232,387	51.6	90,071	27.7
Equity securities	—	—	2,830	0.6	—	—
State and municipal securities	159,262	24.1	102,567	22.8	25,274	7.8
Corporate securities	71,550	10.8	59,812	13.3	47,405	14.6
Total investment securities, available for sale, at fair value	657,451	99.5	450,525	100.0	246,339	75.8
<i>Investment securities, held to maturity, at amortized cost</i>						
State and municipal securities	—	—	—	—	78,672	24.2
Equity securities	3,334	0.5	—	—	—	—
Total investment securities	\$660,785	100 %	\$450,525	100.0 %	\$325,011	100.0 %

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The following table sets forth the book value, maturities and weighted average yields for our investment portfolio at December 31, 2018. The book value for investment securities classified as available for sale is equal to fair market value.

	December 31, 2018		
	Book Value	% of Total Investment Securities	Weighted Average Yield
<b>(dollars in thousands)</b>			
Investment securities, available for sale			
<i>U.S. Treasury securities:</i>			
Maturing within one year	\$ 5,012	0.7 %	2.4 %
Maturing in one to five years	19,638	3.0	1.5
Maturing in five to ten years	—	0.0	0.0
Maturing after ten years	—	0.0	0.0
Total U.S. Treasury securities	\$ 24,650	3.7 %	1.7 %
<i>Government sponsored entity debt securities:</i>			
Maturing within one year	\$ 14,935	2.3 %	2.3 %
Maturing in one to five years	47,859	7.2	2.4
Maturing in five to ten years	12,453	1.9	2.6
Maturing after ten years	437	0.1	2.6
Total government sponsored entity debt securities	\$ 75,684	11.5 %	2.4 %
<i>Agency mortgage-backed securities:</i>			
Maturing within one year	\$ 12,081	1.8 %	2.6 %
Maturing in one to five years	268,660	40.7	2.9
Maturing in five to ten years	40,025	6.1	2.9
Maturing after ten years	5,539	0.8	3.0
Total agency mortgage-backed securities	\$ 326,305	49.4 %	2.9 %
<i>State and municipal securities <sup>(1)</sup>:</i>			
Maturing within one year	\$ 17,135	2.6 %	3.5 %
Maturing in one to five years	47,151	7.1	3.7
Maturing in five to ten years	64,845	9.8	3.3
Maturing after ten years	30,131	4.6	3.4
Total state and municipal securities	\$ 159,262	24.1 %	3.4 %
<i>Corporate securities:</i>			
Maturing within one year	\$ 2,005	0.3 %	4.0 %
Maturing in one to five years	7,905	1.2	3.7
Maturing in five to ten years	61,640	9.3	5.2
Maturing after ten years	—	0.0	0.0
Total corporate securities	\$ 71,550	10.8 %	5.0 %
Total investment securities, available for sale	\$ 657,451	99.5 %	3.1 %
<i>Equity securities:</i>			
No stated maturity	\$ 3,334	0.5 %	2.4 %
Total investment securities and equity securities	\$ 660,785	100.0 %	3.1 %

(1) Weighted average yield for tax-exempt securities are presented on a tax-equivalent basis assuming a federal statutory income tax rate of 21%.

The table below presents the credit ratings at December 31, 2018 at fair value for our investment securities classified as available for sale.

			December 31, 2018					
	Amortized Cost	Estimated Fair Value	Average Credit Rating					
<b>(dollars in thousands)</b>			AAA	AA+/-	A+/-	BBB+/-	<BBB-	Not Rated
<i>Investment securities available for sale:</i>								
U.S. Treasury securities	\$ 25,018	\$ 24,650	\$ —	\$ 24,650	\$ —	\$ —	\$ —	\$ —
Government sponsored entity debt securities	76,554	75,684	—	75,684	—	—	—	—
Agency mortgage-backed securities	329,690	326,305	6,787	319,518	—	—	—	—
State and municipal securities	156,795	159,262	29,955	100,777	10,458	5,904	491	11,677
Corporate securities	72,302	71,550	—	—	22,894	42,621	2,084	3,951
Total investment securities, available for sale	\$ 660,359	\$ 657,451	\$ 36,742	\$ 520,629	\$ 33,352	\$ 48,525	\$ 2,575	\$ 15,628

**Goodwill and Other Intangible Assets.** Goodwill was \$164.7 million at December 31, 2018 compared to \$98.6 million at December 31, 2017. Goodwill represents the excess of consideration paid in an acquisition over the fair value of the net assets acquired. The \$66.1 million increase in 2018 resulted from goodwill associated with the Alpine acquisition.

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Our other intangible assets, which consist of core deposit and trust relationship intangibles, were \$37.4 million and \$16.9 million at December 31, 2018 and 2017, respectively. The increase in other intangibles primarily reflected the impact of a \$21.1 million core deposit intangible and \$6.3 million customer relationship intangible associated with the Alpine acquisition offset in part by amortization expense of \$17.0 million.

**Liabilities.** Total liabilities increased \$1.07 billion to \$5.03 billion at December 31, 2018 due primarily to the Alpine acquisition.

**Deposits.** We emphasize developing total client relationships with our customers in order to increase our retail and commercial core deposit bases, which are our primary funding sources. Our deposits consist of noninterest-bearing and interest-bearing demand, savings and time deposit accounts.

The following table summarizes our average deposit balances and weighted average rates for the years ended December 31, 2018, 2017 and 2016:

	December 31,					
	2018		2017		2016	
(dollars in thousands)	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
<b>Deposits</b>						
Noninterest-bearing demand	\$ 947,328	—	\$ 620,559	—	\$ 536,965	—
Interest-bearing:						
Checking	981,768	0.36 %	772,478	0.20 %	637,531	0.13 %
Money market	812,639	0.76	533,073	0.46	382,780	0.27
Savings	426,526	0.18	234,143	0.15	163,392	0.15
Time, less than \$250,000	545,295	1.21	398,076	0.87	378,158	0.90
Time, \$250,000 and over	78,817	1.39	60,181	1.04	51,986	0.87
Time, brokered	188,993	2.09	247,819	1.49	215,865	1.37
Total interest-bearing	3,034,038	0.73 %	2,245,770	0.54 %	1,829,712	0.49 %
Total deposits	\$3,981,366	0.55 %	\$2,866,329	0.42 %	\$2,366,677	0.38 %

The following table sets forth the maturity of time deposits of \$250,000 or more and brokered deposits as of December 31, 2018:

	December 31, 2018				
	Maturity Within:				
(dollars in thousands)	Three Months or Less	Three to Six Months	Six to 12 Months	After 12 Months	Total
Time, \$250,000 and over	\$ 15,082	\$ 23,935	\$ 14,097	\$ 22,861	\$ 75,975
Time, brokered	55,133	52,856	39,262	14,389	161,640
Total	\$ 70,215	\$ 76,791	\$ 53,359	\$ 37,250	\$ 237,615

Total deposits increased \$943.1 million to \$4.07 billion at December 31, 2018 as compared to December 31, 2017. This increase primarily resulted from \$1.11 billion of deposits added from the Alpine acquisition. At December 31, 2018, total deposits were comprised of 23.9% noninterest-bearing demand accounts, 56.6% interest-bearing transaction accounts and 19.5% of time deposits. At December 31, 2018, brokered deposits totaled \$161.6 million, or 4.0% of total deposits, compared to \$190.3 million, or 6.1% of total deposits, at December 31, 2017.

**Short-Term Borrowings.** In addition to deposits, we use short-term borrowings, such as federal funds purchased and securities sold under agreements to repurchase, as a source of funds to meet the daily liquidity needs of our customers and fund growth in earning assets. Short-term borrowings were \$124.2 million at December 31, 2018 compared to \$156.1 million at December 31, 2017. The weighted average interest rate on our short-term borrowings was 0.71% and 0.28% at December 31, 2018 and 2017, respectively.

**FHLB Advances and Other Borrowings.** FHLB advances and other borrowings totaled \$640.6 million and \$496.4 million as of December 31, 2018 and 2017, respectively. During 2018, we increased FHLB advances by \$130.4 million, assumed FHLB advances totaling \$18.1 million as a result of the Alpine acquisition and made payments totaling \$4.3 million against our term loan.

## Capital Resources and Liquidity Management

**Capital Resources.** Shareholders' equity is influenced primarily by earnings, dividends, sales and redemptions of common stock and changes in accumulated other comprehensive income caused primarily by fluctuations in unrealized holding gains or losses, net of taxes, on available-for-sale investment securities.

Shareholders' equity increased \$159.0 million to \$608.5 million at December 31, 2018 as compared to December 31, 2017. The increase in shareholders' equity was due primarily to \$139.9 million of common equity issued for the Alpine acquisition. During 2018, we generated net income of \$39.4 million and declared dividends of \$20.0 million to common shareholders.

In conjunction with the acquisition of Alpine, the Company paid \$33.3 million in cash and issued 4,463,200 shares of Midland common stock upon closing of the transaction on February 28, 2018. Additionally, the Company issued \$40.0 million aggregate principal amount of subordinated debentures in October 2017, the proceeds of which were used to fund the payment of the cash portion of the merger consideration.

**Liquidity Management.** Liquidity refers to the measure of our ability to meet the cash flow requirements of depositors and borrowers, while at the same time meeting our operating, capital and strategic cash flow needs, all at a reasonable cost. We continuously monitor our liquidity position to ensure that assets and liabilities are managed in a manner that will meet all short-term and long-term cash requirements. We manage our liquidity position to meet the daily cash flow needs of customers, while maintaining an appropriate balance between assets and liabilities to meet the return on investment objectives of our shareholders.

Integral to our liquidity management is the administration of short-term borrowings. To the extent we are unable to obtain sufficient liquidity through core deposits; we seek to meet our liquidity needs through wholesale funding or other borrowings on either a short- or long-term basis.

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. Securities sold under agreements to repurchase were \$124.2 million at December 31, 2018 compared to \$156.1 million at December 31, 2017.

As of December 31, 2018 and 2017, we had available \$45.0 million and \$55.0 million of unsecured federal funds lines, respectively, with no amounts advanced against the lines at either date. In addition, available lines of credit from the Federal Reserve Discount Window at December 31, 2018 and 2017 were \$56.8 million and \$32.5 million, respectively. Federal Reserve Discount Window lines were collateralized by a pool of commercial real estate loans totaling \$67.6 million and \$36.5 million as of December 31, 2018 and 2017, respectively. We did not have any borrowings outstanding with the Federal Reserve at December 31, 2018 or 2017.

At December 31, 2018 and 2017, we had \$607.6 million and \$459.1 million of outstanding advances from the FHLB, respectively. Based on the values of stock, securities, and loans pledged as collateral, we had \$482.2 million and \$457.6 million of additional borrowing capacity with the FHLB as of December 31, 2018 and 2017, respectively. We also maintain relationships in the capital markets with brokers and dealers to issue certificates of deposit.

The Company is a corporation separate and apart from the Bank and, therefore, must provide for its own liquidity. The Company's main source of funding is dividends declared and paid to us by the Bank. There are statutory, regulatory and debt covenant limitations that affect the ability of the Bank to pay dividends to the Company. Management believes that these limitations will not impact our ability to meet our ongoing short-term cash obligations.

## Regulatory Capital Requirements

We are subject to various regulatory capital requirements administered by the federal and state banking regulators. Failure to meet regulatory capital requirements may result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for "prompt corrective action", we must meet specific

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capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting policies.

The Dodd-Frank Act and the Basel III Rule have established capital standards for banks and bank holding companies. The table below summarizes the minimum capital requirements applicable to us under the Basel III Rule.

Ratio	Basel III	
	Well Capitalized	Adequately Capitalized
Tier 1 leverage ratio	5.0 %	4.0 %
Common equity Tier 1 capital ratio	6.5	4.5
Tier 1 risk-based capital ratio	8.0	6.0
Total risk-based capital ratio	10.0	8.0

In addition to the minimum regulatory capital requirements set forth in the table above, the Basel III Rule implemented a “capital conservation buffer” that is added to the minimum requirements for capital adequacy purposes. A banking organization that fails to meet the required amount of the capital conservation buffer will be subject to limits on capital distributions (e.g., dividends, stock buybacks, etc.) and certain discretionary bonus payments to executive officers. For community banks, the capital conservation buffer requirement was phased in over a three-year period beginning on January 1, 2016. The capital conservation buffer in 2016 was 0.625%, 1.25% in 2017, 1.875% in 2018 and was fully phased in at 2.5% on January 1, 2019.

At December 31, 2018, the Company exceeded all regulatory capital requirements under the Basel III Rule and was considered to be “well-capitalized” with a Tier 1 leverage ratio of 8.53%, a common equity Tier 1 capital ratio of 8.76%, a Tier 1 capital ratio of 10.25% and a total capital ratio of 12.79%.

At December 31, 2018, the Bank exceeded all regulatory capital requirements under the Basel III Rule and was considered to be “well-capitalized” with a Tier 1 leverage ratio of 10.22%, a common equity Tier 1 capital ratio of 12.27%, a Tier 1 capital ratio of 12.27% and a total capital ratio of 12.76%.

## Contractual Obligations

The following table contains supplemental information regarding our total contractual obligations at December 31, 2018:

(dollars in thousands)	Payments Due				Total
	Less than One Year	One to Three Years	Three to Five Years	More than Five Years	
Deposits without a stated maturity	\$3,278,742	\$ —	\$ —	\$ —	\$3,278,742
Time deposits	523,651	233,625	38,151	1	795,428
Securities sold under repurchase agreements	124,235	—	—	—	124,235
FHLB advances and other borrowings	73,074	36,767	420,790	110,000	640,631
Operating lease obligations	2,878	4,554	3,352	2,249	13,033
Subordinated debt	—	—	—	94,134	94,134
Trust preferred debentures	—	—	—	47,794	47,794
Total contractual obligations	<u>\$4,002,580</u>	<u>\$ 274,946</u>	<u>\$ 462,293</u>	<u>\$ 254,178</u>	<u>\$4,993,997</u>

We believe that we will be able to meet our contractual obligations as they come due through the maintenance of adequate cash levels. We expect to maintain adequate cash levels through profitability, loan and securities repayment and maturity activity and continued deposit gathering activities. We have in place various borrowing mechanisms for both short-term and long-term liquidity needs.

## Off-Balance Sheet Arrangements

We have limited off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

In the normal course of business, we enter into various transactions, which, in accordance with GAAP, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets. Most of these commitments mature within two years and are expected to expire without being drawn upon. Standby letters of credit are included in the determination of the amount of risk-based capital that the Company and the Bank are required to hold.

We enter into contractual loan commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon customers maintaining specific credit standards until the time of loan funding. We decrease our exposure to losses under these commitments by subjecting them to credit approval and monitoring procedures. We assess the credit risk associated with certain commitments to extend credit and establish a liability for probable credit losses.

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

We guarantee the distributions and payments for redemption or liquidation of the trust preferred securities issued by our wholly owned subsidiary business trusts to the extent of funds held by the trusts. Although this guarantee is not separately recorded, the obligation underlying the guarantee is fully reflected on our consolidated balance sheets as junior subordinated debentures held by subsidiary trusts. The junior subordinated debentures currently qualify as Tier 1 capital under the Federal Reserve capital adequacy guidelines.

### **Quantitative and Qualitative Disclosures About Market Risk**

**Market Risk.** Market risk represents the risk of loss due to changes in market values of assets and liabilities. We incur market risk in the normal course of business through exposures to market interest rates, equity prices, and credit spreads. We are primarily exposed to interest rate risk as a result of offering a wide array of financial products to our customers and secondarily to price risk from investments in securities backed by mortgage loans.

#### ***Interest Rate Risk***

**Overview.** Interest rate risk is the risk to earnings and value arising from changes in market interest rates. Interest rate risk arises from timing differences in the repricings and maturities of interest-earning assets and interest-bearing liabilities (reprice risk), changes in the expected maturities of assets and liabilities arising from embedded options, such as borrowers' ability to prepay residential mortgage loans at any time and depositors' ability to redeem certificates of deposit before maturity (option risk), changes in the shape of the yield curve where interest rates increase or decrease in a nonparallel fashion (yield curve risk), and changes in spread relationships between different yield curves, such as U.S. Treasuries and LIBOR (basis risk).

Our board of directors' Asset-Liability Committee ("ALCO") establishes broad policy limits with respect to interest rate risk. ALCO establishes specific operating guidelines within the parameters of the board of directors' policies. In general, we seek to minimize the impact of changing interest rates on net interest income and the economic values of assets and liabilities. Our ALCO meets quarterly to monitor the level of interest rate risk sensitivity to ensure compliance with the board of directors' approved risk limits.

Interest rate risk management is an active process that encompasses monitoring loan and deposit flows complemented by investment and funding activities. Effective management of interest rate risk begins with understanding the dynamic characteristics of assets and liabilities and determining the appropriate interest rate risk posture given business forecasts, management objectives, market expectations, and policy constraints.

An asset sensitive position refers to a balance sheet position in which an increase in short-term interest rates is expected to generate higher net interest income, as rates earned on our interest-earning assets would reprice upward

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more quickly than rates paid on our interest-bearing liabilities, thus expanding our net interest margin. Conversely, a liability sensitive position refers to a balance sheet position in which an increase in short-term interest rates is expected to generate lower net interest income, as rates paid on our interest-bearing liabilities would reprice upward more quickly than rates earned on our interest-earning assets, thus compressing our net interest margin.

*Income Simulation and Economic Value Analysis.* Interest rate risk measurement is calculated and reported to the ALCO at least quarterly. The information reported includes period-end results and identifies any policy limits exceeded, along with an assessment of the policy limit breach and the action plan and timeline for resolution, mitigation, or assumption of the risk.

We use two approaches to model interest rate risk: Net Interest Income at Risk (“NII at Risk”) and Economic Value of Equity (“EVE”). Under NII at Risk, net interest income is modeled utilizing various assumptions for assets, liabilities, and derivatives. EVE measures the period end market value of assets minus the market value of liabilities and the change in this value as rates change. EVE is a period end measurement.

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The following table shows NII at Risk at the dates indicated:

(dollars in thousands)	Net Interest Income Sensitivity (Shocks)			
	Immediate Change in Rates			
	-100	-50	+100	+200
December 31, 2018:				
Dollar change	\$ (8,497)	N/A	\$ 2,694	\$ 4,623
Percent change	(4.3)%	N/A	1.4 %	2.4 %
December 31, 2017:				
Dollar change	N/A	\$ (3,065)	\$ 3,546	\$ 6,504
Percent change	N/A	(2.2)%	2.6 %	4.7 %
December 31, 2016:				
Dollar change	N/A	\$ (2,857)	\$ 4,154	\$ 8,162
Percent change	N/A	(2.8)%	4.0 %	7.9 %

We report NII at Risk to isolate the change in income related solely to interest earning assets and interest-bearing liabilities. The NII at Risk results included in the table above reflect the analysis used quarterly by management. It models gradual -100, +100 and +200 basis point parallel shifts in market interest rates, implied by the forward yield curve over the next twelve months. Since short-term interest rates remained low through 2017 and 2016, a NII at Risk analysis with an assumed decrease of 100 basis points did not provide meaningful results at December 31, 2017 and 2016.

We are within Board policy limits for the -100, +100 and +200 basis point scenarios. NII at Risk reported at December 31, 2018, projects that our earnings exhibit decreased sensitivity to changes in interest rates compared to December 31, 2017. In recent periods, the amount of fixed rate assets increased, resulting in a position shift from slightly asset sensitive to asset sensitive.

The following table shows EVE at the dates indicated:

(dollars in thousands)	Economic Value of Equity Sensitivity (Shocks)			
	Immediate Change in Rates			
	-100	-50	+100	+200
December 31, 2018:				
Dollar change	\$ (80,035)	N/A	\$ 40,599	\$ 69,461
Percent change	(12.7)%	N/A	6.4 %	11.0 %
December 31, 2017:				
Dollar change	N/A	\$ (20,384)	\$ 29,803	\$ 53,786
Percent change	N/A	(4.6)%	6.7 %	12.0 %
December 31, 2016:				
Dollar change	N/A	\$ (16,159)	\$ 27,135	\$ 50,676
Percent change	N/A	(4.7)%	7.9 %	14.8 %

The EVE results included in the table above reflect the analysis used quarterly by management. It models immediate -100, +100 and +200 basis point parallel shifts in market interest rates.

We are within board policy limits for the -100, +100 and +200 basis point scenarios. The EVE reported at December 31, 2018 projects that as interest rates increase, the economic value of equity position will increase, and as interest rates decrease, the economic value of equity position will decrease. When interest rates rise, fixed rate assets generally lose economic value; the longer the duration, the greater the value lost. The opposite is true when interest rates fall. Since short-term interest rates remained low through 2017 and 2016, an EVE analysis with an assumed decrease of 100 basis points did not provide meaningful results at December 31, 2017 and 2016.

**Price Risk.** Price risk represents the risk of loss arising from adverse movements in the prices of financial instruments that are carried at fair value and subject to fair value accounting. We have price risk from equity investments and investments in mortgage-backed securities.

### Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements in accordance with GAAP requires us to make estimates and judgments that affect our reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other



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assumptions that are believed to be reasonable under current circumstances, results of which form the basis for making judgments about the carrying value of certain assets and liabilities that are not readily available from other sources. We evaluate our estimates on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

Accounting policies, as described in detail in the notes to our consolidated financial statements are an integral part of our financial statements. A thorough understanding of these accounting policies is essential when reviewing our reported results of operations and our financial position. We believe that the critical accounting policies and estimates discussed below require us to make difficult, subjective or complex judgments about matters that are inherently uncertain. Changes in these estimates, that are likely to occur from period to period, or using different estimates that we could have reasonably used in the current period, would have a material impact on our financial position, results of operations or liquidity.

**Loans Held for Investment.** Loans held for investment includes loans we originate and retain on the balance sheet and other loans acquired through acquisition. Our accounting policies require that we evaluate all acquired loans for evidence of deterioration in credit quality since origination and to evaluate whether it is probable that we will collect all contractually required payments from the borrower. Loans acquired with evidence of deterioration in credit quality are accounted for as PCI loans. For PCI loans, the amount of contractually required payments receivable in excess of the amount of future cash flows we estimate at acquisition is considered a nonaccretable difference. The PCI loans are reflected on the balance sheet based on the amount expected to be collected. In addition, the amount of future cash flows expected to be collected in excess of the fair value of the PCI loans is considered accretable yield and is recognized in interest income on a level-yield basis over the estimated life of the acquired loans.

We reevaluate our original estimates of cash flows expected to be collected over the life of the PCI loans on a quarterly basis. If it is probable, based on current information and events, that there is a significant increase in cash flows previously expected to be collected, or if actual cash flows are significantly greater than cash flows previously expected, we adjust the amount of accretable yield by reclassification from nonaccretable difference. Conversely, if we believe we will be unable to collect all cash flows expected at acquisition, we establish a valuation allowance through the allowance for loan losses with a change to the provision for loan losses.

Determining the accretable and nonaccretable amounts at acquisition and the ongoing reevaluation of expected cash flows are considered critical accounting estimates, as these require significant judgment and the use of subjective measurements, including our assessment of historical loss rates, changes in the nature of the portfolio and delinquency trends.

**Investment Securities.** Investment securities generally must be classified as equity, held to maturity, available for sale or trading. The Company classifies its securities as equity, available for sale or held to maturity at the time of purchase. Investments in stock of a publicly traded company or in mutual funds are classified as equity securities. Held-to-maturity securities are principally debt securities that we have both the positive intent and ability to hold to maturity. Trading securities are held primarily for sale in the near term to generate income. Securities that do not meet the definition of equity, trading or held to maturity are classified as available for sale.

The classification of investment securities is significant since it directly impacts the accounting for unrealized gains and losses on these securities. Unrealized gains and losses on equity securities and trading securities flow directly through earnings during the periods in which they arise. Trading and available-for-sale securities are measured at fair value each reporting period. Unrealized gains and losses on available-for-sale securities are recorded as a separate component of shareholders' equity (accumulated other comprehensive income or loss) and do not affect earnings until realized or deemed to be OTTI. Investment securities that are classified as held to maturity are recorded at amortized cost, unless deemed to be OTTI.

The fair values of investment securities are generally determined by various pricing models. We evaluate the methodologies used to develop the resulting fair values. We perform a quarterly analysis on the pricing of investment securities to ensure that the prices represent a reasonable estimate of the fair value. Our procedures include initial and ongoing review of pricing methodologies and trends. We seek to ensure prices represent a reasonable estimate of fair value through the use of broker quotes, current sales transactions from our portfolio and pricing techniques, which are based on the net present value of future expected cash flows discounted at a rate of return market participants would require. Significant inputs used in internal pricing techniques are estimated by type of underlying collateral, estimated

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prepayment speeds where applicable and appropriate discount rates. As a result of this analysis, if we determine there is a more appropriate fair value, the price is adjusted accordingly.

When the level and volume of trading activity for certain securities has significantly declined or when we believe that pricing is based in part on forced liquidation or distressed sales, we estimate fair value based on a combination of pricing information and an internal model using a discounted cash flow approach. We make certain significant assumptions in addition to those discussed above related to the liquidity risk premium, specific nonperformance and default experience in the collateral underlying the security. The values resulting from each approach are weighted to derive the final fair value for each security trading in an inactive market.

The fair value of investment securities is a critical accounting estimate. Changes in fair value estimates that occur from period to period, or the use of different estimates that could have been reasonably used in the current period, could have a material impact on our financial position, results of operations or liquidity.

**Allowance for Loan Losses.** The allowance for loan losses represents management's estimate of probable and reasonably estimable credit losses inherent in the held for investment loan portfolio. In determining the allowance, we estimate losses on specific loans, or groups of loans, where the probable loss can be identified and reasonably estimated. On a quarterly basis, we assess the risk inherent in our loan portfolio based on qualitative and quantitative trends in the portfolio, including the internal risk classification of loans, historical loss rates, changes in the nature of the portfolio, industry concentrations, delinquency trends, detailed reviews of significant loans with identified weaknesses and the impacts of local, regional and national economic factors on the quality of the loan portfolio. Based on this analysis, we record a provision for loan losses in order to maintain the allowance at appropriate levels.

For PCI loans, an allowance may be required subsequent to their acquisition. The PCI loans are recorded at their estimated fair value at the date of acquisition, with the estimated fair value including a component for estimated credit losses. A portion of the allowance, however, may be set aside in the future if a PCI loan pool experiences a decrease in expected cash flows as compared to those projected at the acquisition date.

Determining the amount of the allowance is considered a critical accounting estimate, as it requires significant judgment and the use of subjective measurements, including management's assessment of overall portfolio quality. The allowance is maintained at an amount we believe is sufficient to provide for estimated losses inherent in our loan portfolio at each balance sheet date, and fluctuations in the provision for loan losses may result from management's assessment of the adequacy of the allowance. Changes in these estimates and assumptions are possible and may have a material impact on our allowance, and therefore our financial position, liquidity or results of operations.

**Mortgage Servicing Rights.** The Company sells residential and commercial FHA mortgage loans in the secondary market. MSR resulting from us retaining the right to service the loans sold are carried at the lower of the initial capitalized amount, net of accumulated amortization, or estimated fair value. MSR are amortized in proportion to and over the period of estimated net servicing income.

The Company periodically evaluates its mortgage servicing rights asset for impairment. Impairment is assessed based on the fair value of net servicing cash flows at each reporting date using estimated prepayment speeds of the underlying mortgage loans serviced and stratifications based on the risk characteristics of the underlying loans. The fair value of our servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, replacement reserves and other economic factors which are estimated based on current market conditions.

Determining the fair value of our MSR for impairment assessment purposes is considered a critical accounting estimate, as it requires significant judgment and the use of subjective measurements. Changes in these estimates and assumptions are possible and may have a material impact on our financial position, results of operations or liquidity.

**Goodwill.** Our goodwill impairment test is performed as of September 30<sup>th</sup> each year and on an interim basis if an event or circumstances indicates that it is likely impairment has occurred. Goodwill is evaluated for impairment at the reporting unit level. Reporting units are defined as the same level as, or one level below, an operating segment. An operating segment is a component of a business for which separate financial information is available that management regularly evaluates in deciding how to allocate resources and assess performance.

In 2018, we performed a qualitative (“Step 0”) assessment to determine if our goodwill was impaired. The qualitative assessment involved the examination of changes in macroeconomic conditions, industry and market conditions, overall financial performance, cost factors and other relevant entity-specific events, including changes in management and other key personnel and changes in the share price of the Company’s common stock.

A business that performs the qualitative assessment may first qualitatively assess whether it is more likely-than-not (i.e., the likelihood of greater than 50%) that the fair value of a reporting unit is less than its carrying value. If it is determined that the fair value of a reporting unit is more likely-than-not less than its carrying value, the business would then perform the traditional goodwill impairment test. Under the traditional goodwill impairment test, the business would determine whether the fair value of the reporting unit is less than its carrying value, including goodwill under the Step 1 assessment. Step 2 of the goodwill impairment test is only required if the carrying value of the reporting unit is greater than its fair value as determined under Step 1. Step 2 compares the implied fair market value of goodwill to its carrying value. If the carrying value of goodwill exceeds its implied fair market value, an impairment loss is recognized. That loss is equal to the carrying amount of goodwill that is in excess of its implied fair market value.

**Deferred Income Taxes.** We use the asset and liability method of accounting for income taxes as prescribed by GAAP. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Accounting for deferred income taxes is a critical accounting estimate because we exercise significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. Management’s determination of the realization of deferred tax assets is based upon management’s judgment of various future events and uncertainties, including the timing and amount of future income, reversing temporary differences which may offset, and the implementation of various tax plans to maximize realization of the deferred tax asset. These judgments and estimates are inherently subjective and reviewed on a continual basis as regulatory and business factors change. Any reduction in estimated future taxable income may require us to record a valuation allowance against our deferred tax assets. A valuation allowance would result in additional income tax expense in such period, which would negatively affect earnings.

#### **Item 7A – Quantitative and Qualitative Disclosures About Market Risk**

The quantitative and qualitative disclosures about market risk are included under “Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Quantitative and Qualitative Disclosures About Market Risk.”

**Item 8 – Financial Statements and Supplementary Data**



Crowe LLP  
Independent Member Crowe Global

**Report of Independent Registered Public Accounting Firm**

Shareholders and the Board of Directors of Midland States Bancorp, Inc.  
Effingham, Illinois

**Opinions on the Financial Statements and Internal Control over Financial Reporting**

We have audited the accompanying consolidated balance sheets of Midland States Bancorp, Inc. (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

**Basis for Opinions**

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Report. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included

performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### **Definition and Limitations of Internal Control Over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Crowe LLP

Crowe LLP

We have served as the Company's auditor since 2017.

Indianapolis, Indiana  
February 27, 2019



KPMG LLP  
Suite 900  
10 South Broadway  
St. Louis, MO 63102-1761

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders  
Midland States Bancorp, Inc.:

We have audited the accompanying consolidated statements of income, comprehensive income, shareholders' equity, and cash flows of Midland States Bancorp, Inc. and its subsidiaries (the Company) for the year ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and the cash flows of Midland States Bancorp, Inc. and its subsidiaries for the year ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

*KPMG LLP*

St. Louis, Missouri  
March 10, 2017

## MIDLAND STATES BANCORP, INC.

## CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share data)

	December 31,	
	2018	2017
<b>Assets</b>		
Cash and due from banks	\$ 210,780	\$ 214,519
Federal funds sold	2,920	683
Cash and cash equivalents	213,700	215,202
Investment securities available for sale, at fair value	657,451	450,525
Equity securities, at fair value	3,334	—
Loans	4,137,551	3,226,678
Allowance for loan losses	(20,903)	(16,431)
Total loans, net	4,116,648	3,210,247
Loans held for sale, at fair value	30,401	50,089
Premises and equipment, net	94,840	76,162
Other real estate owned	3,483	5,708
Nonmarketable equity securities	42,472	34,796
Accrued interest receivable	16,560	11,715
Mortgage servicing rights, at lower of cost or fair value	53,447	56,352
Mortgage servicing rights held for sale	3,545	10,176
Intangible assets	37,376	16,932
Goodwill	164,673	98,624
Cash surrender value of life insurance policies	138,783	113,366
Accrued income taxes receivable	8,809	8,358
Deferred tax assets, net	1,251	12,024
Other assets	50,900	42,425
Total assets	<u>\$ 5,637,673</u>	<u>\$ 4,412,701</u>
<b>Liabilities and Shareholders' Equity</b>		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 972,164	\$ 724,443
Interest-bearing	3,102,006	2,406,646
Total deposits	4,074,170	3,131,089
Short-term borrowings	124,235	156,126
FHLB advances and other borrowings	640,631	496,436
Subordinated debt	94,134	93,972
Trust preferred debentures	47,794	47,330
Accrued interest payable	4,855	2,531
Other liabilities	43,329	35,672
Total liabilities	<u>5,029,148</u>	<u>3,963,156</u>
Shareholders' Equity:		
Preferred stock, Series H, \$2 par value, \$1,000 per share liquidation value; 2,636 shares authorized, issued and outstanding at December 31, 2018 and 2017, respectively	2,781	2,970
Common stock, \$0.01 par value; 40,000,000 shares authorized; 23,751,798 and 19,122,049 shares issued and outstanding at December 31, 2018 and 2017, respectively	238	191
Capital surplus	473,833	330,148
Retained earnings	133,781	114,478
Accumulated other comprehensive (loss) income	(2,108)	1,758
Total shareholders' equity	<u>608,525</u>	<u>449,545</u>
Total liabilities and shareholders' equity	<u>\$ 5,637,673</u>	<u>\$ 4,412,701</u>

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

**MIDLAND STATES BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
*(dollars in thousands, except per share data)*

	Years Ended December 31,		
	2018	2017	2016
Interest income:			
Loans:			
Taxable	\$ 194,688	\$ 135,898	\$ 102,211
Tax exempt	3,327	1,255	1,155
Loans held for sale	1,749	2,297	3,320
Investment securities:			
Taxable	13,894	6,763	9,294
Tax exempt	4,553	3,741	3,634
Nonmarketable equity securities	1,980	1,194	687
Federal funds sold and cash investments	3,176	1,965	948
Total interest income	<u>223,367</u>	<u>153,113</u>	<u>121,249</u>
Interest expense:			
Deposits	22,054	12,132	8,936
Short-term borrowings	698	379	303
FHLB advances and other borrowings	11,347	4,594	1,057
Subordinated debt	6,056	4,054	3,858
Trust preferred debentures	3,125	2,292	1,841
Total interest expense	<u>43,280</u>	<u>23,451</u>	<u>15,995</u>
Net interest income	180,087	129,662	105,254
Provision for loan losses	9,430	9,556	5,591
Net interest income after provision for loan losses	<u>170,657</u>	<u>120,106</u>	<u>99,663</u>
Noninterest income:			
Commercial FHA revenue	10,980	17,752	22,064
Residential mortgage banking revenue	5,729	9,119	13,389
Wealth management revenue	20,513	13,340	8,091
Service charges on deposit accounts	10,440	5,975	3,904
Interchange revenue	10,674	5,353	3,750
FDIC loss-sharing expense	—	—	(1,661)
Gain on sales of investment securities, net	464	222	14,702
Other-than-temporary impairment on investment securities	—	—	(824)
Gain on sales of other real estate owned	544	145	113
Other income	12,447	7,456	8,529
Total noninterest income	<u>71,791</u>	<u>59,362</u>	<u>72,057</u>
Noninterest expense:			
Salaries and employee benefits	97,410	78,712	66,293
Occupancy and equipment	18,914	14,659	13,080
Data processing	26,062	15,171	10,658
FDIC insurance	2,209	1,806	1,707
Professional	12,782	14,359	8,049
Marketing	4,757	3,290	2,733
Communications	4,405	2,473	2,150
Loan expense	2,033	1,954	1,957
Other real estate owned	524	800	935
Amortization of intangible assets	6,956	3,325	2,147
Loss on mortgage servicing rights held for sale	458	4,059	—
Other expense	15,133	12,389	11,580
Total noninterest expense	<u>191,643</u>	<u>152,997</u>	<u>121,289</u>
Income before income taxes	50,805	26,471	50,431
Income taxes	11,384	10,415	18,889
Net income	39,421	16,056	31,542
Preferred stock dividends and premium amortization	141	83	—
Net income available to common shareholders	<u>\$ 39,280</u>	<u>\$ 15,973</u>	<u>\$ 31,542</u>
Per common share data:			
Basic earnings per common share	\$ 1.69	\$ 0.89	\$ 2.22
Diluted earnings per common share	\$ 1.66	\$ 0.87	\$ 2.17
Weighted average common shares outstanding	23,130,475	17,781,631	14,130,552
Weighted average diluted common shares outstanding	23,549,025	18,283,214	14,428,839

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



**MIDLAND STATES BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
*(dollars in thousands)*

	<b>Years Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net income	\$ 39,421	\$ 16,056	\$ 31,542
Other comprehensive (loss) income:			
Investment securities available for sale:			
Unrealized (losses) gains that occurred during the period	(4,845)	443	3,556
Reclassification adjustment for securities transferred from held to maturity to available for sale	—	3,366	—
Reclassification adjustment for realized net gains on sales of investment securities included in net income	(464)	(222)	(14,702)
Income tax effect	1,443	(1,104)	4,469
Change in investment securities available for sale, net of tax	(3,866)	2,483	(6,677)
Investment securities held to maturity:			
Amortization of unrealized gain on investment securities transferred from available-for-sale	—	(188)	(66)
Income tax effect	—	73	29
Change in investment securities held to maturity, net of tax	—	(115)	(37)
Cash flow hedges:			
Change in fair value of interest rate swap	—	—	126
Income tax effect	—	—	(51)
Change in cash flow hedges, net of tax	—	—	75
Other comprehensive (loss) income, net of tax	(3,866)	2,368	(6,639)
Total comprehensive income	<u>\$ 35,555</u>	<u>\$ 18,424</u>	<u>\$ 24,903</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

MIDLAND STATES BANCORP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

(dollars in thousands, except per share data)

	Preferred stock	Common stock	Capital surplus	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balances, December 31, 2015	\$ —	\$ 118	\$ 135,909	\$ 90,824	\$ 6,029	\$ 232,880
Net income	—	—	—	31,542	—	31,542
Compensation expense for stock option grants	—	—	492	—	—	492
Amortization of restricted stock awards	—	—	555	—	—	555
Common dividends declared (\$0.72 per share)	—	—	—	(9,853)	—	(9,853)
Initial public offering of 3,590,065 shares of common stock, net of issuance costs	—	36	71,439	—	—	71,475
Issuance of common stock under employee benefit plans	—	1	1,317	—	—	1,318
Other comprehensive loss	—	—	—	—	(6,639)	(6,639)
Balances, December 31, 2016	\$ —	\$ 155	\$ 209,712	\$ 112,513	\$ (610)	\$ 321,770
Net income	—	—	—	16,056	—	16,056
Compensation expense for stock option grants	—	—	548	—	—	548
Amortization of restricted stock awards	—	—	836	—	—	836
Preferred dividends declared	—	—	—	(184)	—	(184)
Preferred stock, premium amortization	(101)	—	—	101	—	—
Common dividends declared (\$0.80 per share)	—	—	—	(14,008)	—	(14,008)
Acquisition of CedarPoint Investment Advisors, Inc.	—	1	3,350	—	—	3,351
Acquisition of Centru Financial Corporation	3,071	32	112,480	—	—	115,583
Issuance of common stock under employee benefit plans	—	3	3,222	—	—	3,225
Other comprehensive income	—	—	—	—	2,368	2,368
Balances, December 31, 2017	\$ 2,970	\$ 191	\$ 330,148	\$ 114,478	\$ 1,758	\$ 449,545
Net income	—	—	—	39,421	—	39,421
Compensation expense for stock option grants	—	—	334	—	—	334
Amortization of restricted stock awards	—	—	1,199	—	—	1,199
Preferred dividends declared	—	—	—	(330)	—	(330)
Preferred stock, premium amortization	(189)	—	—	189	—	—
Common dividends declared (\$0.88 per share)	—	—	—	(19,977)	—	(19,977)
Acquisition of Alpine Bancorporation, Inc.	—	45	139,876	—	—	139,921
Issuance of common stock under employee benefit plans	—	2	2,276	—	—	2,278
Other comprehensive loss	—	—	—	—	(3,866)	(3,866)
Balances, December 31, 2018	\$ 2,781	\$ 238	\$ 473,833	\$ 133,781	\$ (2,108)	\$ 608,525

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

**MIDLAND STATES BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(dollars in thousands)*

	Years Ended December 31,		
	2018	2017	2016
<b>Cash flows from operating activities:</b>			
Net income	\$ 39,421	\$ 16,056	\$ 31,542
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Provision for loan losses	9,430	9,556	5,591
Depreciation on premises and equipment	6,166	5,014	5,080
Amortization of intangible assets	6,956	3,325	2,147
FDIC loss-sharing expense	—	—	1,661
Compensation expense for stock option grants	334	548	492
Amortization of restricted stock awards	1,199	836	555
Increase in cash surrender value of life insurance	(3,579)	(2,791)	(2,150)
Provision for deferred income taxes	10,522	12,032	14,541
Investment securities amortization, net	3,898	1,960	1,133
Other-than-temporary impairment on investment securities	—	—	824
Gain on sales of investment securities, net	(464)	(222)	(14,702)
Gain on sales of other real estate owned	(544)	(145)	(113)
Impairment of other real estate owned	301	244	247
Origination of loans held for sale	(557,305)	(778,626)	(1,176,716)
Proceeds from sales of loans held for sale	590,282	815,471	1,184,739
Gain on loans sold and held for sale	(11,165)	(24,295)	(35,127)
Loss on disposals of premises and equipment	385	64	97
Gain on proceeds from bank-owned life insurance	(709)	—	(732)
Amortization of mortgage servicing rights	2,949	5,107	6,141
(Recapture) impairment of mortgage servicing rights	(449)	2,324	3,135
Loss on mortgage servicing rights held for sale	458	4,059	—
<b>Net change in operating assets and liabilities:</b>			
Accrued interest receivable	(431)	(1,137)	(505)
Accrued interest payable	1,785	1,211	66
Accrued income taxes receivable	(451)	(2,496)	2,892
Other assets	(5,712)	5,189	(6,399)
Other liabilities	3,783	(2,835)	(313)
Net cash provided by operating activities	<u>97,060</u>	<u>70,449</u>	<u>24,126</u>
<b>Cash flows from investing activities:</b>			
<b>Investment securities available for sale:</b>			
Purchases	(76,289)	(259,098)	(198,680)
Sales	20,178	22,595	115,999
Maturities and payments	131,220	247,929	74,948
<b>Investment securities held to maturity:</b>			
Purchases	—	(3,155)	(2,617)
Maturities	—	16,889	11,019
<b>Equity Securities:</b>			
Purchases	(59)	—	—
Sales	7,733	—	—
Net increase in loans	(131,114)	(238,398)	(335,943)
Proceeds from sale of premises and equipment	33	4,286	11
Purchases of premises and equipment	(7,200)	(6,182)	(2,179)
Proceeds from sales of mortgage servicing rights held for sale	12,994	—	—
Proceeds from settlements of bank-owned life insurance	1,449	—	1,385
Purchase of bank-owned life insurance	—	—	(20,000)
Purchases of nonmarketable equity securities	(20,737)	(18,376)	(4,103)
Sales of nonmarketable equity securities	15,099	11,233	90
Proceeds from sales of other real estate owned	3,879	6,189	6,199
Net cash acquired (paid) in acquisitions	36,153	(18,519)	(5,191)
Net cash used in investing activities	<u>(6,661)</u>	<u>(234,607)</u>	<u>(359,062)</u>
<b>Cash flows from financing activities:</b>			
Net (decrease) increase in deposits	(168,049)	(13,144)	36,718
Net (decrease) increase in short-term borrowings	(31,891)	10,135	24,019
Proceeds from FHLB borrowings	1,017,080	447,357	1,015,000
Payments made on FHLB borrowings	(886,726)	(320,857)	(817,500)
Proceeds from other borrowings	—	39,964	—
Payments made on other borrowings	(4,286)	(3,198)	—
Proceeds from issuance of subordinated debt	—	39,354	—
Payments made on subordinated debt	—	—	(8,000)
Cash dividends paid on preferred stock	(330)	(184)	—
Cash dividends paid on common stock	(19,977)	(14,008)	(9,853)

**MIDLAND STATES BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT'D)**  
*(dollars in thousands)*

	<b>Years Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Proceeds from issuance of common stock in initial public offering, net of issuance costs	—	—	71,475
Proceeds from issuance of common stock under employee benefit plans	2,278	3,225	1,318
Net cash (used in) provided by financing activities	<u>(91,901)</u>	<u>188,644</u>	<u>313,177</u>
Net (decrease) increase in cash and cash equivalents	<u>(1,502)</u>	<u>24,486</u>	<u>(21,759)</u>
<b>Cash and cash equivalents:</b>			
Beginning of period	\$ 215,202	\$ 190,716	\$ 212,475
End of period	<u>\$ 213,700</u>	<u>\$ 215,202</u>	<u>\$ 190,716</u>
<b>Supplemental disclosures of cash flow information:</b>			
<b>Cash payments for:</b>			
Interest paid on deposits and borrowed funds	\$ 40,956	\$ 21,965	\$ 15,929
Income tax paid	580	653	1,073
<b>Supplemental disclosures of noncash investing and financing activities:</b>			
Transfer of investment securities held to maturity to investment securities available for sale	\$ —	\$ 64,520	\$ —
Transfer of investment securities available for sale to equity securities	2,830	—	—
Transfer of loans to other real estate owned	1,104	3,718	4,839
Transfer of premises and equipment to assets held for sale	—	3,988	—
Transfer of mortgage servicing rights at lower of cost or market to mortgage servicing rights held for sale	3,649	14,234	—

*The accompanying notes are an integral part of the consolidated financial statements.*

**MIDLAND STATES BANCORP, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 – Summary of Significant Accounting Policies**

***Nature of Operations***

Midland States Bancorp, Inc. (the “Company,” “we,” “our,” or “us”) is a diversified financial holding company headquartered in Effingham, Illinois. Its wholly-owned banking subsidiary, Midland States Bank (the “Bank”), has branches across Illinois and in Missouri, and provides a full range of commercial and consumer banking products and services, business equipment financing, merchant credit card services, trust and investment management, and insurance and financial planning services. In addition, multifamily and healthcare facility FHA financing is provided through Love Funding, our non-bank subsidiary.

On February 28, 2018, we completed the acquisition of Alpine Bancorporation, Inc. (“Alpine”) and its banking subsidiary, Alpine Bank & Trust Co. (“Alpine Bank”), as more fully described in Note 2 to the consolidated financial statements. Through the Alpine acquisition, we greatly expanded our commercial and retail banking presence in northern Illinois.

Our principal business activity has been lending to and accepting deposits from individuals, businesses, municipalities and other entities. We have derived income principally from interest charged on loans and, to a lesser extent, from interest and dividends earned on investment securities. We have also derived income from noninterest sources, such as: fees received in connection with various lending and deposit services; wealth management services; residential mortgage loan originations, sales and servicing; and, from time to time, gains on sales of assets. Our income sources also include Love Funding’s commercial FHA loan origination and servicing income. Our principal expenses include interest expense on deposits and borrowings, operating expenses, such as salaries and employee benefits, occupancy and equipment expenses, data processing costs, professional fees and other noninterest expenses, provisions for loan losses and income tax expense.

***Basis of Presentation***

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and conform to predominant practices within the banking industry. Management of the Company has made a number of estimates and assumptions related to the reporting of assets and liabilities to prepare the consolidated financial statements in conformity with GAAP. Actual results may differ from those estimates. In the opinion of management, all adjustments, consisting of normal recurring accruals considered necessary for a fair presentation of the results of operations for annual periods presented herein, have been included. Certain reclassifications of 2017 and 2016 amounts have been made to conform to the 2018 presentation but do not have an effect on net income.

***Principles of Consolidation***

The consolidated financial statements include the accounts of the parent company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. Assets held for customers in a fiduciary or agency capacity, other than trust cash on deposit with the Bank, are not assets of the Company and, accordingly, are not included in the accompanying consolidated financial statements.

### ***Business Combinations***

The Company accounts for business combinations under the acquisition method of accounting. Under the acquisition method, tangible and intangible identifiable assets acquired, liabilities assumed and any noncontrolling interests in the acquiree are recorded at fair value as of the acquisition date. The Company includes the results of operations of the acquired companies in the consolidated statements of income from the date of acquisition. Transaction costs and costs to restructure the acquired company are expensed as incurred. Goodwill is recognized as the excess of the acquisition price over the estimated fair value of the net assets acquired. If the fair value of the net assets acquired is greater than the acquisition price, a bargain purchase gain is recognized and recorded in noninterest income.

### ***Cash and Cash Equivalents***

Cash and cash equivalents include cash on hand, amounts due from banks, which includes amounts on deposit with the Federal Reserve, interest-bearing deposits with banks or other financial institutions and federal funds sold. Generally, federal funds are sold for one-day periods, but not longer than 30 days.

### ***Investment Securities***

Investment securities consist of debt securities of the U.S. Treasury, government sponsored entities, states, counties, municipalities, corporations, agency mortgage-backed securities and non-agency mortgage-backed securities. Securities transactions are recorded on a trade date basis. The Company classifies its securities as equity, available for sale or held to maturity at the time of purchase. Investments in stock of a publicly traded company or in mutual funds are classified as equity securities. Equity securities are recorded at fair value with unrealized gains and losses recognized in earnings. Held-to-maturity securities are those debt instruments which the Company has the positive intent and ability to hold until maturity. Held-to-maturity securities are recorded at cost, adjusted for the amortization of premiums or accretion of discounts. All other securities are classified as available for sale. Available-for-sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are included in other comprehensive income and the related accumulated unrealized holding gains and losses are reported as a separate component of shareholders' equity until realized.

On a quarterly basis, the Company makes an assessment to determine whether there have been any events or circumstances to indicate that a security for which there is an unrealized loss is impaired on an other than temporary basis. This determination requires significant judgment. A decline in the fair value of any available-for-sale or held-to-maturity security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. In estimating other-than-temporary impairment ("OTTI") losses, we consider the severity and duration of the impairment; the financial condition and near-term prospects of the issuer, which for debt securities considers external credit ratings and recent downgrades; and the intent and ability of the Company to hold the security for a period of time sufficient for a recovery in value.

Purchase premiums are amortized over the estimated life or to the earliest call date and purchase discounts are accreted over the estimated life of the related investment security as an adjustment to yield using the effective interest method. Unamortized premiums, unaccreted discounts, and early payment premiums are recognized in interest income upon disposition of the related security. Interest and dividend income are recognized when earned. Realized gains and losses from the sale of available-for-sale securities are determined using the specific identification method and are included in other noninterest income. Also, when applicable, realized gains and losses are reported as a reclassification adjustment, net of tax, in other comprehensive income.

### ***Nonmarketable Equity Securities***

Nonmarketable equity securities include the Bank's required investments in the stock of the Federal Home Loan Bank ("FHLB") and the Federal Reserve Bank ("FRB"). The Bank is a member of the FHLB system as well as its regional FRB. Members of the FHLB are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock and FRB stock are both carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

**Loans**

*Non-Purchased Credit Impaired loans (“Non-PCI loans”).* Non-PCI loans, for which the Company has the intent and ability to hold for the foreseeable future, or until maturity or payoff, are classified as loans in the consolidated balance sheets. Non-PCI loans are stated at the principal amount outstanding, net of unamortized deferred loan origination fees and costs and net of any unearned discount or unamortized premium. Interest income is recorded on the accrual basis in accordance with the terms of the respective loan. Loans are considered delinquent when principal or interest payments are past due 30 days or more; delinquent loans may remain on accrual status between 30 days and 89 days past due. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest payments are past due 90 days or when, in the opinion of management, there is a reasonable doubt as to collectability in the normal course of business. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan’s principal balance is deemed collectible. Loans are restored to accrual status when loans become well-secured and management believes full collectability of principal and interest is probable. Nonrefundable loan fees and related direct costs associated with the origination or purchase of loans are deferred and netted against outstanding loan balances. The net deferred fees or costs are recognized as an adjustment to interest income over the contractual life of the loans using the interest method or taken into income when the related loans are paid off or sold. The amortization of loan fees or costs is discontinued when a loan is placed on nonaccrual status.

*Lease Financing.* The Company provides financing leases to small businesses for purchases of business equipment. Under the direct financing method of accounting, the minimum lease payments to be received under the lease contract, together with the estimated unguaranteed residual values (approximately 3% to 15% of the cost of the related equipment), are recorded as lease receivables when the lease is signed and the leased property is delivered to the customer. The excess of the minimum lease payments and residual values over the cost of the equipment is recorded as unearned lease income. Unearned lease income is recognized over the term of the lease on a basis that results in an approximate level rate of return on the unrecovered lease investment. Lease income is recognized on the interest method. Residual value is the estimated fair market value of the equipment on lease at lease termination. In estimating the equipment’s fair value at lease termination, we rely on historical experience by equipment type and manufacturer and, where available, valuations by independent appraisers, adjusted for known trends. Our estimates are reviewed continuously to ensure reasonableness; however, the amounts we will ultimately realize could differ from the estimated amounts. If the review results in a lower estimate than had been previously established, a determination is made as to whether the decline in estimated residual value is other-than-temporary. If the decline in estimated unguaranteed residual value is judged to be other-than-temporary, the accounting for the transaction is revised using the changed estimate. The resulting reduction in the investment is recognized as a loss in the period in which the estimate is changed. An upward adjustment of the estimated residual value is not recorded.

*Purchased Credit Impaired loans (“PCI loans”).* We account for PCI loans under ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (“acquired impaired loan accounting”) when we acquire loans deemed to be impaired or when there is evidence of credit deterioration since their origination and it is probable at the date of acquisition that we would be unable to collect all contractually required payments. Revolving credit agreements, such as commercial lines of credit and home equity lines, and lease financings are excluded from PCI loans.

For PCI loans, we (i) determine the contractual amount and timing of undiscounted principal and interest payments (the “undiscounted contractual cash flows”) and (ii) estimate the amount and timing of undiscounted expected principal and interest payments including expected prepayments (the “undiscounted expected cash flows”). Under acquired impaired loan accounting, the difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the nonaccretable difference. The nonaccretable difference represents an estimate of the loss exposure of principal and interest related to the PCI loans and such amount is subject to change over time based on the performance of such loans. The carrying value of PCI loans is initially determined by discounting expected cash flows. The carrying value of PCI loans is reduced by payments received, both principal and interest, and increased by the portion of the accretable yield recognized as interest income on a level-yield basis over the estimated life of the acquired loans.

The excess of expected cash flows at acquisition over the initial fair value of the PCI loans is referred to as the “accretable yield” and is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. Subsequent to acquisition, the Company aggregates loans into pools of loans with common credit risk characteristics such as loan type and risk rating. Increases

in expected cash flows compared to those previously estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in expected cash flows compared to those previously estimated usually result in a provision for loan losses and the establishment of an allowance for loan losses. As the accretable yield increases or decreases from changes in cash flow expectations, the offset is a decrease or increase to the nonaccretable difference or an addition to accretable yield. The accretable yield is measured at each financial reporting date based on information then currently available and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the loans.

Under acquired impaired loan accounting, PCI loans are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when expected cash flows are reasonably estimable. Accordingly, PCI loans that are contractually past due are still considered to be accruing and performing loans as long as there is an expectation that the estimated cash flows will be received. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans.

*Impaired loans.* A loan is considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include loans on nonaccrual status, any loan past due 90 days or more and still accruing interest, and performing troubled debt restructured loans. Income from loans on nonaccrual status is recognized to the extent cash is received and when the loan's principal balance is deemed collectible. Depending on a particular loan's circumstances, we measure impairment of a loan based upon either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent. A loan is considered collateral dependent when repayment of the loan is based solely on the liquidation of the collateral. Fair value, where possible, is determined by independent appraisals, typically on an annual basis. Between appraisal periods, the fair value may be adjusted based on specific events, such as if deterioration of quality of the collateral comes to our attention as part of our problem loan monitoring process, or if discussions with the borrower lead us to believe the last appraised value no longer reflects the actual market for the collateral. The impairment amount on a collateral-dependent loan is charged-off to the allowance if deemed not collectible and the impairment amount on a loan that is not collateral-dependent is set up as a specific reserve.

*Troubled Debt Restructurings.* A loan is classified as a troubled debt restructuring when we grant a concession to a borrower experiencing financial difficulties. These concessions may include a reduction of the interest rate, principal or accrued interest, extension of the maturity date or other actions intended to minimize potential losses. Loans restructured at a market rate of a new loan with comparable risk at the time the loan is modified may be excluded from restructured loan disclosures in years subsequent to the restructuring if the loans are in compliance with their modified terms. A loan that has been placed on nonaccrual that is subsequently restructured will usually remain on nonaccrual status until the borrower is able to demonstrate repayment performance in compliance with the restructured terms for a sustained period, typically for six months. A loan that has not been placed on nonaccrual may be restructured and such loan may remain on accrual status after such restructuring. In these circumstances, the borrower has made payments before and after the restructuring. Generally, this restructuring involves a reduction in the loan interest rate and/or a change to interest-only payments for a period of time. A restructured loan is considered impaired despite its accrual status and a specific reserve is calculated based on the present value of expected cash flows discounted at the loan's effective interest rate or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent.

*Allowance for Loan Losses.* The allowance for loan losses ("allowance") provides for probable losses in the loan portfolio that have been identified with specific customer relationships and for probable losses believed to be inherent in the remainder of the loan portfolio but that have not been specifically identified. The allowance is comprised of specific allowances (assessed for loans that have known credit weaknesses), general allowances based on historical loan loss experience for each loan type and other factors for imprecision in the subjective nature of the general allowance methodology and an allowance for PCI loans. Management evaluates the allowance on a quarterly basis in an effort to ensure the level is appropriate to absorb probable losses inherent in the loan portfolio. Our federal and state banking regulators, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Our regulators may require the Company to recognize additions to the allowance based on their judgments related to information available to them at the time of their examinations.

Acquired non-PCI and PCI loans are recorded at their estimated fair value at the date of acquisition, with the estimated fair value including a component for estimated credit losses. These loans, however, may require an allowance subsequent to their acquisition. An allowance may be set aside in the future for acquired non-PCI loans based on our



allowance methodology for non-PCI loans. An allowance may be set aside in the future for PCI loans if the PCI loan pools experience a decrease in expected cash flows as compared to those projected at the acquisition date.

In determining the allowance and the related provision for loan losses, the Company considers three principal elements: (i) valuation allowances based upon probable losses identified during the review of impaired commercial, commercial real estate, construction and land development loans, (ii) allocations, by loan classes, on loan portfolios based on historical loan loss experience and on other factors for the imprecision in the overall allowance methodology and (iii) valuation allowances on PCI loan pools based on decreases in expected cash flows.

The first element reflects the Company's establishment of valuation allowances based upon probable losses identified during the systematic review of impaired commercial, commercial real estate, construction and land development loans in the non-purchased credit impaired loan portfolios. These estimates are based upon a number of objective factors, such as payment history, financial condition of the borrower, expected future cash flows and discounted collateral exposure. The Company measures the investment in an impaired loan based on one of three methods: the loan's observable market price; the fair value of the collateral; or the present value of expected future cash flows discounted at the loan's effective interest rate. It is the Company's general policy to, at least annually, obtain new appraisals on impaired loans that are primarily secured by real estate. When the Company determines that the net realizable value of the collateral is less than the carrying value of an impaired loan on nonaccrual status and a portion is deemed not collectible, the portion of the impairment that is deemed not collectible is charged off and deducted from the allowance. The remaining carrying value of the impaired loan is classified as a nonperforming loan. When the Company determines that the net realizable value of the collateral is less than the carrying value of an impaired loan but believes it is probable it will recover this impairment, the Company establishes a valuation allowance for such impairment.

The second element relates to allocations, by loan classes, on loan portfolios based on historical loan loss experience and on other factors for the imprecision in the overall allowance methodology. All loans are not evaluated individually for impairment and any individually evaluated loans determined not to be impaired are segmented into groups based on similar risk characteristics, as described above. Historical loss rates for each risk group, which are updated quarterly, are quantified using all recorded loan charge-offs and recoveries and changes in specific allowances on loans. These historical loss rates for each risk group are used as the starting point to determine the level of the allowance. The Company's methodology incorporates an estimated loss emergence period for each loan category. The loss emergence period is the period of time from when a borrower experiences a loss event and when the actual loss is recognized in the financial statements, generally at the time of initial charge-off of the loan balance. The Company's methodology also includes qualitative risk factors that allow management to adjust its estimate of losses based on the most recent information available and to address other limitations in the quantitative component that is based on historical loss rates. Such risk factors are generally reviewed and updated quarterly, as appropriate, and are adjusted to reflect actual changes and anticipated changes in national and local economic conditions and developments, the volume and severity of delinquent and internally classified loans, loan concentrations, assessment of trends in collateral values, and changes in lending policies and procedures, including underwriting standards and collections, charge-off and recovery practices.

The third element relates to PCI loans. PCI loans are aggregated into pools based on common risk characteristics. On a quarterly basis, the expected future cash flow of each pool is estimated based on various factors including changes in property values of collateral dependent loans, default rates and loss severities. Decreases in estimates of expected cash flows within a pool generally result in a charge to the provision for loan losses and a corresponding increase in the allowance allocated to PCI loans for the particular pool. Increases in estimates of expected cash flows within a pool generally result in, first, a reduction in the allowance allocated to PCI loans for the particular pool to the extent an allowance has been previously recorded, and then as an adjustment to the accretable yield for the pool, which will increase amounts recognized in interest income in current and subsequent periods.

### ***Loans Held for Sale***

Loans held for sale consist of residential and commercial FHA mortgage loans originated with the intent to sell. Loans held for sale are carried at fair value, determined individually, as of the balance sheet date. The Company believes the fair value method better reflects the economic risks associated with these loans. Fair value measurements on loans held for sale are based on quoted market prices for similar loans in the secondary market, market quotes from anticipated sales contracts and commitments, or contract prices from firm sales commitments. The changes in the fair value of loans held for sale are reflected in commercial FHA revenue and residential mortgage banking revenue on the consolidated statements of income.

### ***Mortgage Repurchase Reserve***

The Company sells residential mortgage loans to investors in the normal course of business. Residential mortgage loans sold to investors are predominantly conventional residential first lien mortgages originated under our usual underwriting procedures, and are sold on a nonrecourse basis. The Company's agreements to sell residential mortgage loans usually require general representations and warranties on the underlying loans sold, related to credit information, loan documentation, collateral, and insurability, which if subsequently untrue or breached, could require the Company to indemnify or repurchase certain loans affected. The balance in the repurchase reserve at the balance sheet date reflects the estimated amount of potential loss the Company could incur from repurchasing a loan, as well as loss reimbursements, indemnification, and other "make whole" settlement resolutions. Refer to Note 22 in the consolidated financial statements for additional information on the mortgage repurchase reserve.

### ***Premises and Equipment***

Premises, furniture and equipment, and leasehold improvements are stated at cost less accumulated depreciation. Depreciation expense is computed principally on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on a straight-line basis over the shorter of the life of the asset or the lease term. Estimated useful lives of premises and equipment range from 10 to 40 years and from 3 to 10 years, respectively. Maintenance and repairs are charged to operating expenses as incurred, while improvements that extend the useful life of assets are capitalized and depreciated over the estimated remaining life.

We periodically review the carrying value of our long-lived assets to determine if impairment has occurred or whether changes in circumstances have occurred that would require a revision to the remaining useful life. In making such determination, we evaluate the performance, on an undiscounted basis, of the underlying operations or assets which give rise to such amount.

### ***Other Real Estate Owned***

Other real estate owned ("OREO") represents properties acquired through foreclosure or other proceedings and is initially recorded at fair value at the date of foreclosure less estimated costs of disposal, which establishes a new cost basis. After foreclosure, OREO is held for sale and is carried at the lower of cost or fair value less estimated costs of disposal. Any write-down to fair value at the time of transfer to OREO is charged to the allowance for loan losses. Fair value for OREO is based on an appraisal performed upon foreclosure. Property is evaluated regularly to ensure the recorded amount is supported by its fair value less estimated costs to dispose. After the initial foreclosure appraisal, fair value is generally determined by an annual appraisal unless known events warrant adjustments to the recorded value. Revenue from the operations of OREO is included in other income in the consolidated statements of income and expense from the operations of OREO and decreases in valuations are included in OREO expense in the consolidated statements of income.

### ***Goodwill and Intangible Assets***

Goodwill resulting from a business combination is generally determined as the excess of the fair value of consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed.

Other intangible assets, which consist of core deposit and acquired customer relationship intangible assets, are typically amortized over a period ranging from 1 to 20 years using an accelerated method of amortization. On a periodic basis, we evaluate events and circumstances that may indicate a change in the recoverability of the carrying value.

### ***Mortgage Servicing Rights***

When loans are sold with servicing retained, a servicing rights asset is capitalized, which represents the then current fair value of future net cash flows expected to be realized for performing servicing activities. As the Company has not elected to subsequently measure servicing assets under the fair value measurement method, the Company follows the amortization method. Mortgage servicing rights are amortized in proportion to and over the period of estimated net servicing income, and assessed for impairment at each reporting date. Mortgage servicing rights are carried at the lower of the initial capitalized amount, net of accumulated amortization, or estimated fair value.

The Company periodically evaluates its mortgage servicing rights asset for impairment. Impairment is assessed based on the fair value of net servicing cash flows at each reporting date using estimated prepayment speeds of the underlying mortgage loans serviced and stratifications based on the risk characteristics of the underlying loans. The fair value of our servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, replacement reserves and other economic factors which are determined based on current market conditions. A valuation allowance is established, through a charge to earnings, to the extent the amortized cost of the mortgage servicing rights exceeds the estimated fair value by stratification. If it is later determined that all or a portion of the temporary impairment no longer exists for a stratification, the valuation is reduced through a recovery to earnings. An other-than-temporary impairment (i.e., recoverability is considered remote when considering interest rates and loan pay off activity) is recognized as a write-down of the mortgage servicing rights asset and the related valuation allowance (to the extent a valuation allowance is available) and then against earnings. A direct write-down permanently reduces the carrying value of the mortgage servicing rights asset and valuation allowance, precluding subsequent recoveries.

We recognize revenue from servicing residential and commercial FHA mortgages as earned based on the specific contractual terms. This revenue, along with changes in impairment on servicing rights, is reported in commercial FHA revenue and residential mortgage banking revenue in the consolidated statements of income.

### ***Mortgage Servicing Rights Held for Sale***

Mortgage servicing rights held for sale consist of residential mortgage servicing rights that management has committed to a plan to sell and has the ability to sell them to a buyer in their present condition. Mortgage servicing rights held for sale are carried at the lower of their carrying value or fair value less estimated costs to sell. Decreases in the valuation of mortgage servicing rights held for sale are included in loss on mortgage servicing rights held for sale in the consolidated statements of income.

### ***Cash Surrender Value of Life Insurance Policies***

We have purchased life insurance policies on the lives of certain officers and key employees and are the owner and beneficiary of the policies. These policies provide an efficient form of funding for long-term retirement and other employee benefits costs. These policies are recorded as cash surrender value of life insurance policies in the consolidated balance sheets at each policy's respective cash surrender value, with changes in value recorded in noninterest income in the consolidated statements of income.

### ***Derivative Financial Instruments***

All derivatives are recognized on the consolidated balance sheet as a component of other assets or other liabilities at their fair value. On the date the derivative contract is entered into, the derivative is designated as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability "cash flow" hedge. Changes in the fair value of a derivative that is highly effective as—and that is designated and qualifies as—a cash flow hedge are recorded in accumulated other comprehensive income, until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings).

We formally document all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as cash flow hedges to specific assets and liabilities on the balance sheet or forecasted transactions. We also formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, hedge accounting is prospectively discontinued, as discussed below.

Hedge accounting is prospectively discontinued when (a) it is determined that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item (including forecasted transactions); (b) the derivative expires or is sold, terminated, or exercised; (c) the derivative is no longer designated as a hedge instrument, because it is unlikely that a forecasted transaction will occur; or (d) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the derivative will continue to be carried on the consolidated balance sheet at its fair value, and gains and losses that were in accumulated other comprehensive income will be recognized immediately in earnings. In all other situations in which hedge accounting is discontinued, the derivative will be carried at its fair value on the consolidated balance sheet, with subsequent changes in its fair value recognized in current-period earnings.

The Company also enters into interest rate lock commitments, which are agreements to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. Interest rate lock commitments for mortgage loans that will be held for resale are carried at fair value on the consolidated balance sheet with changes in fair value reflected in commercial FHA revenue and residential mortgage banking revenue. The Company also has forward loan sales commitments related to its interest rate lock commitments and its loans held for sale. Forward loan sales commitments that meet the definition of a derivative are recorded at fair value in the consolidated balance sheet with changes in fair value reflected in commercial FHA and residential mortgage banking income.

### ***Credit-Related Financial Instruments***

In the ordinary course of business, the Company has entered into credit-related financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. The notional amount of these commitments is not reflected in the consolidated financial statements until they are funded.

A liability for losses related to unfunded commitments is maintained by the Company at a level believed by management to be sufficient to absorb estimated probable losses related to unfunded credit facilities and is included in other liabilities in the consolidated balance sheets. The determination of the adequacy of the liability is based on an evaluation of the unfunded credit facilities, including an assessment of historical commitment utilization experience, credit risk grading and historical loss rates. This process takes into consideration the same risk elements that are analyzed in the determination of the adequacy of the Company's allowance for loan losses, as discussed above. Net adjustments to the liability for unfunded commitments are included in other noninterest expense in the consolidated statements of income. The liability for unfunded commitments totaled \$1.2 million and \$670,000 at December 31, 2018 and 2017, respectively.

### ***Income Taxes***

We file consolidated federal and state income tax returns, with each organization computing its taxes on a separate return basis. The provision for income taxes is based on income as reported in the consolidated financial statements.

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future. The deferred tax assets and liabilities are computed based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

When tax returns are filed, it is highly certain that some positions taken will be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the consolidated financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized

upon settlement with the applicable taxing authority. Interest and penalties associated with unrecognized tax benefits are to be classified as additional income taxes in the consolidated statements of income. The Company evaluated its tax positions and concluded that it had taken no uncertain tax positions that require adjustment in the consolidated financial statements.

### ***Revenue Recognition***

On January 1, 2018, the Company adopted ASU No. 2014-09 “*Revenue from Contracts with Customers*” (Topic 606) and all subsequent ASUs that modified Topic 606. This amendment superseded and replaced nearly all existing revenue recognition guidance, including industry-specific guidance, established a new control-based revenue recognition model, changed the basis for deciding when revenue is recognized over time or at a point in time, provided new and more detailed guidance on specific topics and expanded and improved disclosures about revenue. The impact of applying Topic 606 to the Company’s consolidated financial statements was determined to be immaterial on the measurement or recognition of revenue. The Company elected to implement this standard using the modified retrospective approach, with the cumulative effect recorded as an adjustment to opening retained earnings at January 1, 2018. Since the impact of applying the standard was determined to be immaterial, the Company did not record a cumulative effect adjustment to beginning retained earnings on January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with previous GAAP.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and investment securities. In addition, certain noninterest income streams such as commercial FHA revenue, residential mortgage banking revenue and gain on sales of investment securities, net are also not in scope of the new guidance. Topic 606 is applicable to noninterest income streams such as wealth management revenue, service charges on deposit accounts, interchange revenue, gain on sales of other real estate owned, and certain other noninterest income streams. The recognition of revenue associated with these noninterest income streams did not change significantly from current practice upon adoption of Topic 606. The noninterest income streams considered in-scope by Topic 606 are discussed in Note 25 in the consolidated financial statements.

### ***Stock Compensation Plans***

Compensation cost for share-based payment awards is based on the fair value of the award at the date of grant. The fair value of stock options is estimated at the date of grant using a Black-Scholes option pricing model. The fair value of restricted stock is determined based on the Company’s current market price on the date of grant. Compensation cost is recognized in the consolidated financial statements on a straight-line basis over the requisite service period, which is generally defined as the vesting period. Additionally, the Company accounts for forfeitures as they occur.

### ***Comprehensive Income***

Comprehensive income is defined as net income plus transactions and other occurrences that are the result of non-owner changes in equity. Non-owner equity changes include unrealized gains and losses on available for sale securities and changes in the fair value of cash flow hedges. These are components of comprehensive income and do not have an impact on the Company’s net income.

### ***Earnings per Share***

Earnings per share are calculated utilizing the two-class method. Basic earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of common shares outstanding. Diluted earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of shares adjusted for the dilutive effect of common stock awards.

**Impact of Recently Issued Accounting Standards**

**FASB ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities.”** – In January 2016, the FASB issued this standard which is intended to improve the recognition and measurement of financial instruments. This standard, among other things: (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. The adoption of ASU 2016-1 on January 1, 2018 did not have a material impact on its consolidated financial statements.

**FASB ASU 2016-02, “Leases (Topic 842)”** – In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” This update revises the model to assess how a lease should be classified and provides guidance for lessees and lessors, when presenting right-of-use assets and lease liabilities on the balance sheet. Under the new guidance, lessees will be required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. This update became effective for the Company on January 1, 2019.

In July 2018, the FASB issued supplementary ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides for an additional transition method allowing for a modified retrospective adoption approach where the guidance would only be applied to existing leases in effect at the adoption date and new leases going forward, with a cumulative effect adjustment to retained earnings as of the adoption date and additional required disclosures regarding leasing arrangements only for those periods after adoption. This update also allows lessors to not separate non-lease components from the associated lease component if certain conditions are met. The Company has elected the practical expedients permitted by ASU 2018-11.

The Company developed and is currently executing on a project plan for implementing the provisions of the new lease standard. At the adoption date, the Company reported increased assets and liabilities of approximately \$12.1 million on its consolidated statement of financial condition as a result of recognizing right-of-use assets and lease liabilities related to non-cancelable operating lease agreements for office space, which currently are not recorded on its consolidated statement of financial condition. The Company does not expect the adoption of this guidance will be material to its Consolidated Statement of Income.

**FASB ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”** – In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“CECL”).” The objective of this update is to improve financial reporting by providing timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will use forward-looking information to better understand their credit loss estimates. For public companies that are filers with the SEC, this update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application is permitted for any organization for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. As previously disclosed, the Company has established a cross-functional governance structure, which oversees overall strategy for implementation of Topic 326. Additionally, a working group was formed and has developed a project plan focused on understanding the ASU, researching issues, data requirements, technology solutions and future state processes. The project plan is targeting data and model validation completion during the first half of 2019, with parallel processing of our existing allowance for loan losses model with CECL until implementation. The Company continues to

focus on researching and resolving interpretive accounting issues in the ASU, contemplating various related accounting policies, developing processes and related controls and considering various reporting disclosures. The Company also continues to believe that the adoption of the standard will result in an overall increase in the allowance for loan losses to cover credit losses over the estimated life of the financial assets. However, the magnitude of the increase in its allowance for loan losses at the adoption date will depend upon the nature and characteristics of the portfolio at the adoption date, as well as macroeconomic conditions and forecasts at that time.

***FASB ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*** – In August 2017, the FASB issued this standard, the objectives of which are to: (1) improve the transparency and understandability of information conveyed to financial statement users about an entity’s risk management activities by better aligning the entity’s financial reporting for hedging relationships with those risk management activities; and (2) reduce the complexity of and simplify the application of hedge accounting by preparers. This standard is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The Company currently does not designate any derivative financial instruments as formal hedging relationships, and therefore, does not utilize hedge accounting. However, the Company is currently evaluating this standard to determine whether its provisions will enhance the Company’s ability to employ risk management strategies, while improving the transparency and understanding of those strategies for financial statement users.

***FASB ASU 2018-02, “Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income”*** – In February 2018, ASU 2018-02 was issued following the enactment of the Tax Cuts and Jobs Act (the “Tax Act”), which changed the Company’s federal income tax rate from 35% to 21%. This standard allows an entity to elect a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. The standard is effective for periods beginning after December 15, 2018 although early adoption is permitted. The Company adopted this standard in the first quarter of 2018. The impact of this update on the Company’s consolidated financial statements was not material.

***FASB ASU No. 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement”*** – In August 2018, the FASB issued ASU No. 2018-13 to improve the disclosure requirements on fair value measurements. The amendment removes certain disclosures required by Topic 820 related to transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for timing of transfers between levels; the valuation processes for Level 3 fair value measurements. The update also adds certain disclosure requirements related to changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. The amendments in this update become effective for fiscal years, and interim periods within those fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the impact of adopting the new guidance on its consolidated financial statements, but it is not expected to have a material impact.

***FASB ASU No. 2018-15, “Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract”*** – In August 2018, the FASB issued ASU No. 2018-15 to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments in this update become effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact of adopting the new guidance on its consolidated financial statements.

## **Note 2 – Acquisitions**

*Alpine Bancorporation, Inc.*

On February 28, 2018, the Company completed its acquisition of Alpine and its banking subsidiary, Alpine Bank, which operated 19 locations in northern Illinois. In the aggregate, the Company acquired Alpine for consideration valued at approximately \$173.2 million, which consisted of approximately \$33.3 million in cash and the issuance of

4,463,200 shares of the Company's common stock. The acquisition was accounted for under the acquisition method of accounting. Accordingly, the Company recognized amounts for identifiable assets acquired and liabilities assumed at their estimated acquisition date fair values, while \$22.4 million of transaction and integration costs have been expensed as incurred through December 31, 2018.

Management's preliminary valuation of the tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, and the resulting allocation of the consideration paid for the allocation is reflected in the table below. Prior to the end of the one-year measurement period for finalizing the consideration paid allocation, if information becomes available which would indicate adjustments are required to the allocation, such adjustments will be included in the allocation in the reporting period in which the adjustment amounts are determined. During the fourth quarter of 2018, the Company updated its preliminary valuation of mortgage servicing rights, which required a measurement period adjustment of \$629,000 to increase goodwill.

*Centrue Financial Corporation*

On June 9, 2017, the Company completed its acquisition of Centrue and its banking subsidiary, Centrue Bank, which operated 20 full-service banking centers located principally in northern Illinois. In the aggregate, the Company acquired Centrue for approximately \$176.6 million, which consisted of approximately \$61.0 million in cash and the issuance of 3,219,238 shares of the Company's common stock, 181 shares of Series G preferred stock and 2,635,546 shares of Series H preferred stock. This acquisition was accounted for under the acquisition method of accounting. Accordingly, the Company recognized amounts for identifiable assets acquired and liabilities assumed at their estimated acquisition date fair values, while \$17.9 million of transaction and integration costs were expensed as incurred.



As of June 30, 2018, the Company finalized its valuation of all assets acquired and liabilities assumed in its acquisition of Centru, resulting in no material change to acquisition accounting adjustments. A summary of the fair value of the assets acquired, liabilities assumed and resulting goodwill are included in the table below.

(dollars in thousands)	Alpine	Centru
<b>Assets acquired:</b>		
Cash and cash equivalents	\$ 69,459	\$ 42,461
Investment securities available for sale	293,428	149,013
Equity securities	8,372	—
Loans	786,186	679,582
Loans held for sale	3,416	531
Premises and equipment	18,126	17,147
Other real estate owned	53	4,983
Nonmarketable equity securities	2,038	8,168
Accrued interest receivable	4,414	2,376
Mortgage servicing rights	—	1,933
Mortgage servicing rights held for sale	3,068	—
Intangible assets	27,400	11,070
Cash surrender value of life insurance policies	22,578	36,349
Deferred tax assets, net	—	34,339
Other assets	4,770	2,256
Total assets acquired	1,243,308	990,208
<b>Liabilities assumed:</b>		
Deposits	1,111,130	739,867
Short-term borrowings	—	14,434
FHLB advances and other borrowings	18,127	95,332
Trust preferred debentures	—	7,565
Accrued interest payable	539	275
Deferred tax liabilities, net	1,749	—
Other liabilities	4,500	3,600
Total liabilities assumed	1,136,045	861,073
Net assets acquired	107,263	129,135
Goodwill	65,964	47,444
Total consideration paid	\$ 173,227	\$ 176,579
<b>Intangible assets:</b>		
Core deposit intangible	\$ 21,100	\$ 11,070
Customer relationship intangible	6,300	—
Total intangible assets	\$ 27,400	\$ 11,070
<b>Estimated useful lives:</b>		
Core deposit intangible	13 years	8 years
Customer relationship intangible	13 years	N/A

Goodwill arising from the acquisitions consists largely of the synergies and economies of scale expected from combining the operations of Alpine and Centru into the Company. The goodwill is assigned as part of the Company's banking reporting unit. The portion of the consideration paid allocated to goodwill will not be deductible for tax purposes.

The identifiable assets acquired from Alpine and Centru included core deposit intangibles and customer relationship intangibles, which are being amortized on an accelerated basis as shown above.

Acquired loan data for Alpine and Centrue can be found in the table below:

(dollars in thousands)	Fair Value of Acquired Loans at Acquisition Date	Gross Contractual Amounts Receivable at Acquisition Date	Best Estimate at Acquisition Date of Contractual Cash Flows Not Expected to be Collected
<b>Alpine:</b>			
Acquired receivables subject to ASC 310-30	\$ 34,993	\$ 50,342	\$ 9,254
Acquired receivables not subject to ASC 310-30	751,193	774,836	4,244
<b>Centrue:</b>			
Acquired receivables subject to ASC 310-30	\$ 11,381	\$ 20,253	\$ 7,227
Acquired receivables not subject to ASC 310-30	668,201	821,338	4,835

The unaudited pro-forma financial information below for years ended December 31, 2018 and 2017 gives effect to the Alpine acquisition as if it had occurred on January 1, 2017, which combines the historical results of Alpine with the Company's consolidated statements of income, adjusted for the impact of the application of the acquisition method of accounting including loan discount accretion, intangible assets amortization, and deposit premium accretion, net of taxes. The unaudited pro-forma financial information also gives effect to the Centrue acquisition that closed on June 9, 2017 as if that transaction became effective January 1, 2017. The unaudited pro-forma financial information has been prepared for comparative purposes only and is not necessarily indicative of the results of operations had the acquisition actually occurred on January 1, 2017. No assumptions have been applied regarding revenue enhancements, expense efficiencies or asset dispositions. Only the acquisition related expenses that have been incurred as of December 31, 2018 are included in net income in the table below. Acquisition related expenses associated with Alpine that were recognized and are included in the unaudited pro-forma net income for the year ended December 31, 2018 totaled \$21.5 million on a pre-tax basis.

(dollars in thousands, except per share data)	2018	2017
Revenue <sup>(1)</sup>	\$ 264,670	\$ 280,538
Net income	42,261	31,188
Diluted earnings per common share	\$ 1.73	\$ 1.28

(1) Net interest income plus noninterest income

*CedarPoint Investment Advisors, Inc.*

On March 28, 2017, the Company acquired all of the outstanding capital stock of CedarPoint Investment Advisors, Inc., an SEC registered investment advisory firm, pursuant to an Agreement and Plan of Merger, dated as of March 15, 2017. CedarPoint had approximately \$180.0 million of assets under administration. The Company acquired CedarPoint for \$3.7 million, which consisted of the issuance of 102,000 shares of the Company's common stock and an accrual in other liabilities of \$345,000 for the fair value of 18,000 shares that will be held in a special purpose escrow account (the "escrow shares") as additional consideration until at least March 31, 2019. Payout of the escrow shares is contingent on CedarPoint reaching certain target revenue levels. Intangible assets recognized as a result of the transaction consisted of approximately \$2.4 million in goodwill and \$2.0 million in customer relationship intangibles. The customer relationship intangibles are being amortized on a straight-line basis over 12 years.

**Note 3 – Cash and Due From Banks**

The Bank is required to maintain cash reserves based on the level of certain of its deposits. This reserve requirement may be met by funds on deposit with the FRB and cash on hand. The required balance at December 31, 2018 and 2017 was \$33.6 million and \$25.0 million, respectively.

The Bank maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Bank has not experienced any losses in such accounts. The Bank believes it is not exposed to any significant credit risk from cash and cash equivalents.

**Note 4 – Investment Securities**

Investment securities as of December 31, 2018 and 2017 were as follows:

(dollars in thousands)	2018			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
<b>Available for sale securities</b>				
U.S. Treasury securities	\$ 25,018	\$ —	\$ 368	\$ 24,650
Government sponsored entity debt securities	76,554	17	887	75,684
Agency mortgage-backed securities	329,690	371	3,756	326,305
State and municipal securities	156,795	3,282	815	159,262
Corporate securities	72,302	383	1,135	71,550
Total available for sale securities	<u>\$ 660,359</u>	<u>\$ 4,053</u>	<u>\$ 6,961</u>	<u>\$ 657,451</u>
<b>Equity securities <sup>(1)</sup></b>				<u>\$ 3,334</u>

(dollars in thousands)	2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
<b>Available for sale securities</b>				
U.S. Treasury securities	\$ 28,005	\$ —	\$ 287	\$ 27,718
Government sponsored entity debt securities	25,445	41	275	25,211
Agency mortgage-backed securities	233,606	882	2,101	232,387
State and municipal securities	99,449	3,632	514	102,567
Corporate securities	58,904	1,087	179	59,812
Equity securities <sup>(1)</sup>	2,715	140	25	2,830
Total available for sale securities	<u>\$ 448,124</u>	<u>\$ 5,782</u>	<u>\$ 3,381</u>	<u>\$ 450,525</u>

(1) As a result of accounting guidance adopted in the first quarter of 2018, equity securities are no longer presented within available for sale securities and are now presented within equity securities in the consolidated balance sheet for the current period. For further discussion of this guidance, see Note 1 to the consolidated financial statements.

During 2017, the Company transferred its held to maturity (“HTM”) investment securities portfolio to investment securities available for sale (“AFS”), which had an amortized cost and fair value of \$64.5 million and \$67.9 million, respectively, resulting in \$3.4 million of unrealized gains on investment securities available for sale at time of transfer. As a result of the Centruie acquisition discussed in Note 2 to the consolidated financial statements, the Company underwent a capital planning assessment which included transferring all HTM securities to AFS securities.

Unrealized losses and fair values for investment securities as of December 31, 2018 and 2017, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are summarized as follows:

(dollars in thousands)	2018					
	Less than 12 Months		12 Months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
<b>Available for sale securities</b>						
U.S. Treasury securities	\$ 5,012	\$ 1	\$ 19,638	\$ 367	\$ 24,650	\$ 368
Government sponsored entity debt securities	51,717	195	23,223	692	74,940	887
Agency mortgage-backed securities	139,115	528	126,561	3,228	265,676	3,756
State and municipal securities	15,791	146	27,692	669	43,483	815
Corporate securities	32,616	575	8,535	560	41,151	1,135
Total available for sale securities	<u>\$ 244,251</u>	<u>\$ 1,445</u>	<u>\$ 205,649</u>	<u>\$ 5,516</u>	<u>\$ 449,900</u>	<u>\$ 6,961</u>

(dollars in thousands)	2017					
	Less than 12 Months		12 Months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
<b>Available for sale securities</b>						
U.S. Treasury securities	\$ 19,758	\$ 251	\$ 7,960	\$ 36	\$ 27,718	\$ 287
Government sponsored entity debt securities	24,168	275	—	—	24,168	275
Agency mortgage-backed securities	124,192	1,500	19,530	601	143,722	2,101
State and municipal securities	29,338	331	5,889	183	35,227	514
Corporate securities	5,917	85	3,463	94	9,380	179
Equity securities <sup>(1)</sup>	2,603	25	—	—	2,603	25
Total available for sale securities	<u>\$ 205,976</u>	<u>\$ 2,467</u>	<u>\$ 36,842</u>	<u>\$ 914</u>	<u>\$ 242,818</u>	<u>\$ 3,381</u>

(1) As a result of accounting guidance adopted in the first quarter of 2018, equity securities are no longer presented within available for sale securities and are now presented within equity securities in the consolidated balance sheet for the current period. For further discussion of this guidance, see Note 1 to the consolidated financial statements.

At December 31, 2018 and 2017, 291 and 173 investment securities available for sale, respectively, had unrealized losses with aggregate depreciation of 1.52% and 1.37%, respectively, from their amortized cost basis. The unrealized losses relate principally to the fluctuations in the current interest rate environment. In analyzing an issuer's financial condition, we consider whether the securities are issued by the federal government or its agencies and whether downgrades by bond rating agencies have occurred. The Company does not have the intent to sell and it is not more likely than not that it will be required to sell a security in an unrealized loss position; therefore, the Company does not consider these securities to be other than temporarily impaired at December 31, 2018.

During 2018 and 2017, the Company did not recognize OTTI losses on its investment securities. During 2016, the Company determined that three non-agency mortgage-backed securities, covered by our FDIC loss share agreement, which were sold in October 2016, had OTTI of \$824,000, primarily resulting from changes in expected cash flows. These amounts were recognized as losses in the consolidated statements of income.

The following is a summary of the amortized cost and fair value of available-for-sale investment securities, by maturity, at December 31, 2018. Expected maturities may differ from contractual maturities in mortgage-backed

securities because the mortgages underlying the securities may be prepaid without penalties. The maturities of all other available-for-sale investment securities are based on final contractual maturity.

(dollars in thousands)	Amortized cost	Fair value
<b>Available for sale securities:</b>		
Within one year	\$ 39,092	\$ 39,087
After one year through five years	122,564	122,554
After five years through ten years	138,494	138,937
After ten years	30,519	30,568
Mortgage-backed securities	329,690	326,305
<b>Total available for sale securities</b>	<b>\$ 660,359</b>	<b>\$ 657,451</b>

Proceeds from the sale of securities available for sale were \$20.2 million, \$22.6 million and \$116.0 million for the years ended December 31, 2018, 2017 and 2016, respectively. Gross realized gains from the sale of securities available for sale were \$542,000, \$242,000 and \$15.5 million for the years ended December 31, 2018, 2017 and 2016, respectively. Gross realized losses were \$25,000, \$20,000 and \$837,000 for the years ended December 31, 2018, 2017 and 2016, respectively. On October 4, 2016, the Company sold its previously covered non-agency mortgage-backed securities which had a carrying value of \$72.1 million. These securities were covered under the loss-sharing agreement we entered into with the FDIC in connection with our 2009 acquisition. This agreement was terminated on October 3, 2016. As a result of the sale, the Company realized a gain totaling \$14.3 million.

Proceeds from the sale of equity securities were \$7.7 million for the year ended December 31, 2018. Gross realized losses from the sale of equity securities were \$53,000 and there were no gross realized gains for the year ended December 31, 2018. During the year ended December 31, 2018, the Company recognized net unrealized losses of \$10,000, which was recorded in noninterest income on the consolidated statements of income.

#### Note 5 – Loans

The following table presents total loans outstanding by portfolio, which includes Non-PCI loans and PCI loans, as of December 31, 2018 and 2017:

(dollars in thousands)	2018			2017		
	Non-PCI Loans	PCI Loans <sup>(1)</sup>	Total	Non-PCI Loans	PCI Loans <sup>(1)</sup>	Total
<b>Loans:</b>						
Commercial	\$ 806,027	\$ 4,857	\$ 810,884	\$ 553,257	\$ 2,673	\$ 555,930
Commercial real estate	1,619,903	19,252	1,639,155	1,427,076	12,935	1,440,011
Construction and land development	223,898	8,331	232,229	199,853	734	200,587
<b>Total commercial loans</b>	<b>2,649,828</b>	<b>32,440</b>	<b>2,682,268</b>	<b>2,180,186</b>	<b>16,342</b>	<b>2,196,528</b>
Residential real estate	569,289	8,759	578,048	447,602	5,950	453,552
Consumer	611,408	1,776	613,184	371,286	169	371,455
Lease financing	264,051	—	264,051	205,143	—	205,143
<b>Total loans</b>	<b>\$ 4,094,576</b>	<b>\$ 42,975</b>	<b>\$ 4,137,551</b>	<b>\$ 3,204,217</b>	<b>\$ 22,461</b>	<b>\$ 3,226,678</b>

(1) The unpaid principal balance for PCI loans totaled \$56.9 million and \$32.8 million as of December 31, 2018 and 2017, respectively.

Total loans include net deferred loan fees of \$11.6 million and \$10.1 million at December 31, 2018 and 2017, respectively, and unearned discounts of \$29.2 million and \$20.7 million within the lease financing portfolio at December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017, the Company had commercial and residential loans held for sale, that were originated with the intent to sell, totaling \$30.4 million and \$50.1 million, respectively. During the years ended December 31, 2018 and 2017, the Company sold commercial and residential real estate loans with proceeds totaling \$590.3 million and \$815.5 million, respectively.

The Company monitors and assesses the credit risk of its loan portfolio using the classes set forth below. These classes also represent the segments by which the Company monitors the performance of its loan portfolio and estimates its allowance for loan losses.

*Commercial*—Loans to varying types of businesses, including municipalities, school districts and nonprofit organizations, for the purpose of supporting working capital, operational needs and term financing of equipment. Repayment of such loans is generally provided through operating cash flows of the business. Commercial loans are predominately secured by equipment, inventory, accounts receivable, and other sources of repayment.

*Commercial real estate*—Loans secured by real estate occupied by the borrower for ongoing operations, including loans to borrowers engaged in agricultural production, and non-owner occupied real estate leased to one or more tenants, including commercial office, industrial, special purpose, retail and multi-family residential real estate loans.

*Construction and land development*—Secured loans for the construction of business and residential properties. Real estate construction loans often convert to a real estate commercial loan at the completion of the construction period. Secured development loans are made to borrowers for the purpose of infrastructure improvements to vacant land to create finished marketable residential and commercial lots/land. Most land development loans are originated with the intention that the loans will be paid through the sale of developed lots/land by the developers within twelve months of the completion date. Interest reserves may be established on real estate construction loans.

*Residential real estate*—Loans secured by residential properties that generally do not qualify for secondary market sale; however, the risk to return and/or overall relationship are considered acceptable to the Company. This category also includes loans whereby consumers utilize equity in their personal residence, generally through a second mortgage, as collateral to secure the loan.

*Consumer*—Loans to consumers primarily for the purpose of home improvements, acquiring automobiles, recreational vehicles and boats. Consumer loans consist of relatively small amounts that are spread across many individual borrowers.

*Lease financing*—Our equipment leasing business provides financing leases to varying types of businesses, nationwide, for purchases of business equipment and software. The financing is secured by a first priority interest in the financed assets and generally requires monthly payments.

Commercial, commercial real estate, and construction and land development loans are collectively referred to as the Company's commercial loan portfolio, while residential real estate and consumer loans and lease financing receivables are collectively referred to as the Company's other loan portfolio.

We have extended loans to certain of our directors, executive officers, principal shareholders and their affiliates. These loans were made in the ordinary course of business upon normal terms, including collateralization and interest rates prevailing at the time, and did not involve more than the normal risk of repayment by the borrower. The aggregate loans outstanding to the directors, executive officers, principal shareholders and their affiliates totaled \$26.5 million and \$22.4 million at December 31, 2018 and 2017, respectively. During 2018 and 2017, there were \$11.1 million and \$4.0 million, respectively, of new loans and other additions, while repayments and other reductions totaled \$6.9 million and \$8.1 million, respectively.

### ***Credit Quality Monitoring***

The Company maintains loan policies and credit underwriting standards as part of the process of managing credit risk. These standards include making loans generally within the Company's four main regions, which include eastern, northern and southern Illinois and the St. Louis metropolitan area. Our equipment leasing business provides financing to business customers across the country.

The Company has a loan approval process involving underwriting and individual and group loan approval authorities to consider credit quality and loss exposure at loan origination. The loans in the Company's commercial loan portfolio are risk rated at origination based on the grading system set forth below. All loan authority is based on the aggregate credit to a borrower and its related entities.

The Company's consumer loan portfolio is primarily comprised of both secured and unsecured loans that are relatively small and are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer loan portfolio is largely done on an exception basis. If payments

are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Company's Consumer Collections Group for resolution. Credit quality for the entire consumer loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

Loans in the commercial loan portfolio tend to be larger and more complex than those in the other loan portfolio, and therefore, are subject to more intensive monitoring. All loans in the commercial loan portfolio have an assigned relationship manager, and most borrowers provide periodic financial and operating information that allows the relationship managers to stay abreast of credit quality during the life of the loans. The risk ratings of loans in the commercial loan portfolio are reassessed at least annually, with loans below an acceptable risk rating reassessed more frequently and reviewed by various individuals within the Company at least quarterly.

The Company maintains a centralized independent loan review function that monitors the approval process and ongoing asset quality of the loan portfolio, including the accuracy of loan grades. The Company also maintains an independent appraisal review function that participates in the review of all appraisals obtained by the Company.

### **Credit Quality Indicators**

The Company uses a ten grade risk rating system to monitor the ongoing credit quality of its commercial loan portfolio. These loan grades rank the credit quality of a borrower by measuring liquidity, debt capacity, and coverage and payment behavior as shown in the borrower's financial statements. The risk grades also measure the quality of the borrower's management and the repayment support offered by any guarantors. A summary of the Company's loan grades (or, characteristics of the loans with each grade) is as follows:

*Risk Grades 1-6 (Acceptable Credit Quality)*—All loans in Risk Grades 1 - 6 are considered to be acceptable credit risks by the Company and are grouped for purposes of financial reporting. The six grades essentially represent a ranking of loans that are all viewed to be of acceptable credit quality, taking into consideration the various factors mentioned above, but with varying degrees of financial strength, debt coverage, management and factors that could impact credit quality. Business credits within Risk Grades 1 - 6 range from Risk Grade 1: Excellent (factors include: excellent business credit; excellent debt capacity and coverage; outstanding management; strong guarantors; superior liquidity and net worth; favorable loan-to-value ratios; debt secured by cash or equivalents, or backed by the full faith and credit of the U.S. Government) to Risk Grade 6: Marginal (factors include: acceptable business credit, but with added risk due to specific industry or internal situations; uncertainty associated with performance or repayment ability).

*Risk Grade 7 (Special Mention)*—A business credit that is not acceptable within the Company's loan origination criteria; cash flow may not be adequate or is continually inconsistent to service current debt; financial condition has deteriorated as company trends/management have become inconsistent; the company is slow in furnishing quality financial information; working capital needs of the company are reliant on short-term borrowings; personal guarantees are weak and/or with little or no liquidity; the net worth of the company has deteriorated after recent or continued losses; the loan has potential weaknesses that require the Company's close attention; payment delinquencies becoming more serious; if left uncorrected, these potential weaknesses may, at some future date, result in deterioration of repayment prospects.

*Risk Grade 8 (Substandard)*—A business credit that is inadequately protected by the current financial net worth and paying capacity of the obligor or of the collateral pledged, if any; management has deteriorated or has become non-existent; quality financial information is unattainable; a high level of maintenance is required by the Company; cash flow can no longer support debt requirements; loan payments are continually and/or severely delinquent; negative net worth; personal guaranty has become insignificant; a credit that has a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. The Company still expects a full recovery of all contractual principal and interest payments; however, a possibility exists that the Company will sustain some loss if deficiencies are not corrected.

*Risk Grade 9 (Substandard-Nonaccrual)*—A business credit accounted for on a nonaccrual basis that has all the weaknesses inherent in a loan classified as Risk Grade 8 with the added characteristic that the weaknesses are so pronounced that, on the basis of current financial information, conditions, and values, collection in full is highly questionable; a partial loss is possible and interest is no longer being accrued. This loan meets the definition of an impaired loan. The risk of loss requires analysis to determine whether a valuation allowance needs to be established.

*Risk Grade 10 (Doubtful)*—A business credit that has all the weaknesses inherent in a loan classified as Risk Grade 8 and interest is no longer being accrued, but additional deficiencies make it highly probable that liquidation will not satisfy the majority of the obligation; the primary source of repayment is nonexistent and there is doubt as to the value of the secondary source of repayment; the possibility of loss is likely, but current pending factors could strengthen the credit. This loan meets the definition of an impaired loan. A loan charge-off is recorded when management deems an amount uncollectible; however, the Company will establish a valuation allowance for probable losses, if required.

The Company considers all loans with Risk Grades of 1 – 6 as acceptable credit risks and structures and manages such relationships accordingly. Periodic financial and operating data combined with regular loan officer interactions are deemed adequate to monitor borrower performance. Loans with Risk Grades of 7 are considered “watch credits” and the frequency of loan officer contact and receipt of financial data is increased to stay abreast of borrower performance. Loans with Risk Grades of 8 – 10 are considered problematic and require special care. Further, loans with Risk Grades of 7 – 10 are managed and monitored regularly through a number of processes, procedures and committees, including oversight by a loan administration committee comprised of executive and senior management of the Company, which includes highly structured reporting of financial and operating data, intensive loan officer intervention and strategies to exit, as well as potential management by the Company’s special assets group. Loans not graded are small loans that are monitored by aging status and payment activity.

The following table presents the recorded investment of commercial loans (excluding PCI loans) by risk category as of December 31, 2018 and 2017:

(dollars in thousands)	2018				2017			
	Commercial	Commercial Real Estate	Construction and Land Development	Total	Commercial	Commercial Real Estate	Construction and Land Development	Total
Acceptable credit quality	\$ 748,296	\$ 1,536,127	\$ 218,798	\$ 2,503,221	\$ 510,928	\$ 1,384,630	\$ 191,872	\$ 2,087,430
Special mention	35,103	15,306	3,448	53,857	12,290	11,497	—	23,787
Substandard	14,139	46,976	—	61,115	27,718	14,695	—	42,413
Substandard – nonaccrual	8,489	21,494	1,171	31,154	1,266	12,482	785	14,533
Doubtful	—	—	—	—	—	—	—	—
Not graded	—	—	481	481	1,055	3,772	7,196	12,023
Total (excluding PCI)	\$ 806,027	\$ 1,619,903	\$ 223,898	\$ 2,649,828	\$ 553,257	\$ 1,427,076	\$ 199,853	\$ 2,180,186

The Company evaluates the credit quality of its other loans based primarily on the aging status of the loan and payment activity. Accordingly, loans on nonaccrual status, any loan past due 90 days or more and still accruing interest, and loans modified under troubled debt restructurings are considered to be impaired for purposes of credit quality evaluation. The following table presents the recorded investment of our other loans (excluding PCI loans) based on the credit risk profile of loans that are performing and loans that are impaired as of December 31, 2018 and 2017:

(dollars in thousands)	2018				2017			
	Residential Real Estate	Consumer	Lease Financing	Total	Residential Real Estate	Consumer	Lease Financing	Total
Performing	\$ 562,019	\$ 610,839	\$ 263,094	\$ 1,435,952	\$ 441,418	\$ 370,999	\$ 203,797	\$ 1,016,214
Impaired	7,270	569	957	8,796	6,184	287	1,346	7,817
Total (excluding PCI)	\$ 569,289	\$ 611,408	\$ 264,051	\$ 1,444,748	\$ 447,602	\$ 371,286	\$ 205,143	\$ 1,024,031

**Impaired Loans**

Impaired loans include loans on nonaccrual status, any loan past due 90 days or more and still accruing interest and loans modified under troubled debt restructurings. Impaired loans at December 31, 2018 and 2017 do not include \$43.0 million and \$22.5 million, respectively, of PCI loans. The risk of credit loss on acquired loans was recognized as part of the fair value adjustment at the acquisition date.



A summary of impaired loans (excluding PCI loans) as of December 31, 2018 and 2017 is as follows:

<b>(dollars in thousands)</b>	<b>2018</b>	<b>2017</b>
<b>Nonaccrual loans:</b>		
Commercial	\$ 8,489	\$ 1,266
Commercial real estate	21,494	12,482
Construction and land development	1,171	785
Residential real estate	5,894	5,204
Consumer	388	234
Lease financing	751	1,346
<b>Total nonaccrual loans</b>	<b>38,187</b>	<b>21,317</b>
<b>Accruing loans contractually past due 90 days or more as to interest or principal payments:</b>		
Commercial	4	2,538
Commercial real estate	149	—
Construction and land development	85	—
Residential real estate	566	51
Consumer	51	53
Lease financing	206	—
<b>Total accruing loans contractually past due 90 days or more as to interest or principal payments</b>	<b>1,061</b>	<b>2,642</b>
<b>Loans modified under troubled debt restructurings and still accruing:</b>		
Commercial	435	299
Commercial real estate	2,225	1,515
Construction and land development	51	58
Residential real estate	810	929
Consumer	130	—
Lease financing	—	—
<b>Total loans modified under troubled debt restructurings and still accruing</b>	<b>3,651</b>	<b>2,801</b>
<b>Total impaired loans (excluding PCI)</b>	<b>\$ 42,899</b>	<b>\$ 26,760</b>

There was no interest income recognized on nonaccrual loans during 2018, 2017 and 2016 while the loans were in nonaccrual status. Additional interest income that would have been recorded on nonaccrual loans had they been current in accordance with their original terms was \$1.8 million, \$860,000 and \$718,000 in 2018, 2017 and 2016, respectively. The Company recognized interest income on commercial and commercial real estate loans modified under troubled debt restructurings of \$97,000, \$85,000 and \$339,000 in 2018, 2017 and 2016, respectively.

The following table presents impaired loans (excluding PCI loans) by portfolio and related valuation allowance, as of December 31, 2018 and 2017:

(dollars in thousands)	2018			2017		
	Recorded Investment	Unpaid Principal Balance	Related Valuation Allowance	Recorded Investment	Unpaid Principal Balance	Related Valuation Allowance
Impaired loans with a valuation allowance:						
Commercial	\$ 7,945	\$ 8,102	\$ 4,448	\$ 3,237	\$ 3,297	\$ 526
Commercial real estate	7,496	13,844	523	2,297	3,508	329
Construction and land development	171	171	54	103	102	10
Residential real estate	4,055	4,662	554	4,028	4,705	566
Consumer	428	444	45	266	279	29
Lease financing	766	766	361	1,064	1,064	345
Total impaired loans with a valuation allowance	20,861	27,989	5,985	10,995	12,955	1,805
Impaired loans with no related valuation allowance:						
Commercial	983	4,392	—	866	5,782	—
Commercial real estate	16,372	16,921	—	11,700	17,359	—
Construction and land development	1,136	1,136	—	740	780	—
Residential real estate	3,215	3,516	—	2,156	2,380	—
Consumer	141	145	—	21	21	—
Lease financing	191	191	—	282	282	—
Total impaired loans with no related valuation allowance	22,038	26,301	—	15,765	26,604	—
Total impaired loans:						
Commercial	8,928	12,494	4,448	4,103	9,079	526
Commercial real estate	23,868	30,765	523	13,997	20,867	329
Construction and land development	1,307	1,307	54	843	882	10
Residential real estate	7,270	8,178	554	6,184	7,085	566
Consumer	569	589	45	287	300	29
Lease financing	957	957	361	1,346	1,346	345
Total impaired loans (excluding PCI)	\$ 42,899	\$ 54,290	\$ 5,985	\$ 26,760	\$ 39,559	\$ 1,805

The difference between a loan's recorded investment and the unpaid principal balance represents: (1) a partial charge-off resulting from a confirmed loss due to the value of the collateral securing the loan being below the loan's principal balance and management's assessment that the full collection of the loan balance is not likely and/or (2) payments received on nonaccrual loans that are fully applied to principal on the loan's recorded investment as compared to being applied to principal and interest on the unpaid customer principal and interest balance. The difference between the recorded investment and the unpaid principal balance was \$11.4 million and \$12.8 million at December 31, 2018 and 2017, respectively.

The average balance of impaired loans (excluding PCI loans) and interest income recognized on impaired loans during the years ended December 31, 2018, 2017 and 2016 are included in the table below:

	2018		2017		2016	
	Average Recorded Investment	Interest Income Recognized While on Impaired Status	Average Recorded Investment	Interest Income Recognized While on Impaired Status	Average Recorded Investment	Interest Income Recognized While on Impaired Status
<b>(dollars in thousands)</b>						
Impaired loans with a valuation allowance:						
Commercial	\$ 8,359	\$ 30	\$ 2,969	\$ 15	\$ 3,974	\$ 15
Commercial real estate	8,082	45	5,408	70	2,379	306
Construction and land development	175	3	83	4	87	7
Residential real estate	3,855	41	3,854	38	3,782	30
Consumer	360	—	299	—	221	—
Lease financing	766	—	1,064	—	1,331	—
Total impaired loans with a valuation allowance	21,597	119	13,677	127	11,774	358
Impaired loans with no related valuation allowance:						
Commercial	1,233	—	2,369	—	5,604	1
Commercial real estate	16,253	22	16,822	—	16,847	17
Construction and land development	1,152	—	815	—	—	—
Residential real estate	3,348	22	2,055	3	1,179	2
Consumer	95	—	13	—	26	—
Lease financing	191	—	282	—	—	—
Total impaired loans with no related valuation allowance	22,272	44	22,356	3	23,656	20
Total impaired loans:						
Commercial	9,592	30	5,338	15	9,578	16
Commercial real estate	24,335	67	22,230	70	19,226	323
Construction and land development	1,327	3	898	4	87	7
Residential real estate	7,203	63	5,909	41	4,961	32
Consumer	455	—	312	—	247	—
Lease financing	957	—	1,346	—	1,331	—
Total impaired loans (excluding PCI)	\$ 43,869	\$ 163	\$ 36,033	\$ 130	\$ 35,430	\$ 378

The following table presents the aging status of the recorded investment in loans by portfolio (excluding PCI loans) as of December 31, 2018:

	Accruing Loans			Nonaccrual Loans	Total Past Due	Current	Total Loans
	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More				
<b>(dollars in thousands)</b>							
Commercial	\$ 4,013	\$ 2,581	\$ 4	\$ 8,489	\$ 15,087	\$ 790,940	\$ 806,027
Commercial real estate	1,667	945	149	21,494	24,255	1,595,648	1,619,903
Construction and land development	989	—	85	1,171	2,245	221,653	223,898
Residential real estate	1,292	728	566	5,894	8,480	560,809	569,289
Consumer	5,211	2,533	51	388	8,183	603,225	611,408
Lease financing	4,322	932	206	751	6,211	257,840	264,051
Total loans (excluding PCI)	\$ 17,494	\$ 7,719	\$ 1,061	\$ 38,187	\$ 64,461	\$ 4,030,115	\$ 4,094,576

The following table presents the aging status of the recorded investment in loans by portfolio (excluding PCI loans) as of December 31, 2017:

(dollars in thousands)	Accruing Loans			Nonaccrual Loans	Total Past Due	Current	Total Loans
	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More				
	Commercial	\$ 3,282	\$ 177				
Commercial real estate	3,116	630	—	12,482	16,228	1,410,848	1,427,076
Construction and land development	1,953	—	—	785	2,738	197,115	199,853
Residential real estate	897	632	51	5,204	6,784	440,818	447,602
Consumer	2,824	1,502	53	234	4,613	366,673	371,286
Lease financing	392	—	—	1,346	1,738	203,405	205,143
Total loans (excluding PCI)	<u>\$ 12,464</u>	<u>\$ 2,941</u>	<u>\$ 2,642</u>	<u>\$ 21,317</u>	<u>\$ 39,364</u>	<u>\$ 3,164,853</u>	<u>\$ 3,204,217</u>

### **Troubled Debt Restructurings**

A loan is categorized as a troubled debt restructuring (“TDR”) if a concession is granted to provide for a reduction of either interest or principal due to deterioration in the financial condition of the borrower. TDRs can take the form of a reduction of the stated interest rate, splitting a loan into separate loans with market terms on one loan and concessionary terms on the other loans, receipts of assets from a debtor in partial or full satisfaction of a loan, the extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk, the reduction of the face amount or maturity of the debt as stated in the instrument or other agreement, the reduction of accrued interest, the release of a personal guarantee in a bankruptcy situation or any other concessionary type of renegotiated debt. Loans are not classified as TDRs when the modification is short-term or results in only an insignificant delay or shortfall in the payments to be received.

Loans modified as TDRs for commercial and commercial real estate loans generally consist of allowing commercial borrowers to defer scheduled principal payments and make interest only payments for a specified period of time at the stated interest rate of the original loan agreement or lower payments due to a modification of the loans’ contractual terms. TDRs that continue to accrue interest and are greater than \$50,000 are individually evaluated for impairment, on a quarterly basis, and transferred to nonaccrual status when it is probable that any remaining principal and interest payments due on the loan will not be collected in accordance with the contractual terms of the loan. TDRs that subsequently default are individually evaluated for impairment at the time of default. The allowance for loan losses on TDRs totaled \$557,000 and \$240,000 as of December 31, 2018 and 2017, respectively. The Company had no unfunded commitments in connection with TDRs at December 31, 2018 and 2017.

The Company’s TDRs are identified on a case-by-case basis in connection with the ongoing loan collection processes. The following table presents TDRs by loan portfolio (excluding PCI loans) as of December 31, 2018 and 2017:

(dollars in thousands)	2018			2017		
	Accruing <sup>(1)</sup>	Non-accrual <sup>(2)</sup>	Total	Accruing <sup>(1)</sup>	Non-accrual <sup>(2)</sup>	Total
Commercial	\$ 435	\$ 406	\$ 841	\$ 299	\$ —	\$ 299
Commercial real estate	2,225	9,103	11,328	1,515	9,915	11,430
Construction and land development	51	—	51	58	—	58
Residential real estate	810	853	1,663	929	282	1,211
Consumer	130	—	130	—	—	—
Lease financing	—	—	—	—	—	—
Total loans (excluding PCI)	<u>\$ 3,651</u>	<u>\$ 10,362</u>	<u>\$ 14,013</u>	<u>\$ 2,801</u>	<u>\$ 10,197</u>	<u>\$ 12,998</u>

(1) These loans are still accruing interest.

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

The following table presents a summary of loans by portfolio that were restructured during the year ended December 31, 2018 and the loans by portfolio that were modified as TDRs within the previous twelve months that subsequently defaulted during the year ended December 31, 2018:

(dollars in thousands)	Commercial Loan Portfolio			Other Loan Portfolio			Total
	Commercial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Lease Financing	
<i>Troubled debt restructurings:</i>							
Number of loans	2	2	—	7	25	—	36
Pre-modification outstanding balance	\$ 423	\$ 1,571	\$ —	\$ 708	\$ 130	\$ —	\$ 2,832
Post-modification outstanding balance	408	1,565	—	696	130	—	2,799
<i>Troubled debt restructurings that subsequently defaulted</i>							
Number of loans	—	—	—	—	—	—	—
Recorded balance	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

The following table presents a summary of loans by portfolio that were restructured during the year ended December 31, 2017 and the loans by portfolio that were modified as TDRs within the previous twelve months that subsequently defaulted during the year ended December 31, 2017:

(dollars in thousands)	Commercial Loan Portfolio			Other Loan Portfolio			Total
	Commercial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Lease Financing	
<i>Troubled debt restructurings:</i>							
Number of loans	1	1	—	4	—	—	6
Pre-modification outstanding balance	\$ 362	\$ 323	\$ —	\$ 528	\$ —	\$ —	\$ 1,213
Post-modification outstanding balance	299	323	—	508	—	—	1,130
<i>Troubled debt restructurings that subsequently defaulted</i>							
Number of loans	—	—	—	—	—	—	—
Recorded balance	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

The following table presents a summary of loans by portfolio that were restructured during the year ended December 31, 2016 and the loans by portfolio that were modified as TDRs within the previous twelve months that subsequently defaulted during the year ended December 31, 2016:

(dollars in thousands)	Commercial Loan Portfolio			Other Loan Portfolio			Total
	Commercial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Lease Financing	
<i>Troubled debt restructurings:</i>							
Number of loans	3	2	—	3	—	—	8
Pre-modification outstanding balance	\$ 685	\$ 10,207	\$ —	\$ 206	\$ —	\$ —	\$ 11,098
Post-modification outstanding balance	647	10,139	—	206	—	—	10,992
<i>Troubled debt restructurings that subsequently defaulted</i>							
Number of loans	—	1	—	—	—	—	1
Recorded balance	\$ —	\$ 28	\$ —	\$ —	\$ —	\$ —	\$ 28

**Purchased Credit Impaired Loans**

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date without a carryover of the related allowance for loan losses. PCI loans are purchased loans that have evidence of credit deterioration since origination, and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration as of the purchase date may include factors such as past due and nonaccrual status. The difference between contractually required principal and interest at acquisition and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in impairment, which is recorded as

provision for loan losses in the consolidated statements of income. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable to accretable with a positive impact on interest income. Further, any excess cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. Accretion recorded as loan interest income totaled \$6.1 million, \$5.5 million and \$8.6 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Accretable yield of PCI loans, or income expected to be collected was as follows for the years ended December 31, 2018, 2017 and 2016:

<b>(dollars in thousands)</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Balance, beginning of period	\$ 5,732	\$ 9,035	\$ 10,526
New loans purchased – Alpine acquisition	6,095	—	—
New loans purchased – Centruie acquisition	—	1,929	—
Accretion	(6,092)	(5,546)	(8,579)
Other adjustments (including maturities, charge-offs and impact of changes in timing of expected cash flows)	2,682	120	915
Reclassification from non-accretable	3,823	194	6,173
Balance, end of period	<u>\$ 12,240</u>	<u>\$ 5,732</u>	<u>\$ 9,035</u>

### ***Allowance for Loan Losses***

The Company's loan portfolio is principally comprised of commercial, commercial real estate, construction and land development, residential real estate and consumer loans and lease financing receivables. The principal risks to each category of loans are as follows:

*Commercial* – The principal risk of commercial loans is that these loans are primarily made based on the identified cash flow of the borrower and secondarily on the collateral underlying the loans. Most often, this collateral consists of accounts receivable, inventory and equipment. Inventory and equipment may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. If the cash flow from business operations is reduced, the borrower's ability to repay the loan may be impaired. As such, repayment of such loans is often more sensitive than other types of loans to adverse conditions in the general economy.

*Commercial real estate* – As with commercial loans, repayment of commercial real estate loans is often dependent on the borrower's ability to make repayment from the cash flow of the commercial venture. While commercial real estate loans are collateralized by the borrower's underlying real estate, foreclosure on such assets may be more difficult than with other types of collateralized loans because of the possible effect the foreclosure would have on the borrower's business, and property values may tend to be partially based upon the value of the business situated on the property.

*Construction and land development* – Construction and land development lending involves additional risks not generally present in other types of lending because funds are advanced upon the estimated future value of the project, which is uncertain prior to its completion and at the time the loan is made, and costs may exceed realizable values in declining real estate markets. Moreover, if the estimate of the value of the completed project proves to be overstated or market values or rental rates decline, the collateral may prove to be inadequate security for the repayment of the loan. Additional funds may also be required to complete the project, and the project may have to be held for an unspecified period of time before a disposition can occur.

*Residential real estate* – The principal risk to residential real estate lending is associated with residential loans not sold into the secondary market. In such cases, the value of the underlying property may have deteriorated as a result of a change in the residential real estate market, and the borrower may have little incentive to repay the loan or continue living in the property. Additionally, in areas with high vacancy rates, reselling the property without substantial loss may be difficult.

*Consumer* – The repayment of consumer loans is typically dependent on the borrower remaining employed through the life of the loan, as well as the possibility that the collateral underlying the loan may not be adequately maintained by the borrower.

*Lease financing* – Our financing leases are primarily for business equipment leased to varying types of businesses, nationwide, for the purchase of business equipment and software. If the cash flow from business operations is reduced, the business’s ability to repay may become impaired.

Changes in the allowance for loan losses for the years ended December 31, 2018, 2017 and 2016 were as follows:

(dollars in thousands)	2018			2017			2016		
	Non-PCI Loans	PCI Loans	Total	Non-PCI Loans	PCI Loans	Total	Non-PCI Loans	PCI Loans	Total
Balance, beginning of period	\$ 14,902	\$ 1,529	\$ 16,431	\$ 13,744	\$ 1,118	\$ 14,862	\$ 14,093	\$ 1,895	\$ 15,988
Provision for loan losses	9,246	184	9,430	9,295	261	9,556	6,425	(834)	5,591
Loan charge-offs	(6,844)	(145)	(6,989)	(9,822)	—	(9,822)	(7,668)	(68)	(7,736)
Loan recoveries	2,031	—	2,031	1,685	150	1,835	894	125	1,019
Net loan (charge-offs) recoveries	(4,813)	(145)	(4,958)	(8,137)	150	(7,987)	(6,774)	57	(6,717)
Balance, end of period	\$ 19,335	\$ 1,568	\$ 20,903	\$ 14,902	\$ 1,529	\$ 16,431	\$ 13,744	\$ 1,118	\$ 14,862

In 2018, the Company recorded \$6.8 million of non-PCI loan charge-offs. In 2017, the Company recorded \$9.8 million of non-PCI loan charge-offs, which included a \$4.6 million charge-off on a nonperforming commercial real estate loan to one borrower and a \$1.2 million charge-off on nonperforming commercial loans related to a single credit relationship as a result of the deterioration in the borrower’s collateral position on the respective loans. In 2016, the Company recorded \$7.7 million of non-PCI loan charge-offs, which included a \$1.6 million charge-off on a nonperforming commercial loan to one borrower, a \$1.4 million charge-off on a nonperforming commercial loan to one borrower and a \$530,000 charge-off on nonperforming commercial loans related to a single credit relationship as a result of the deterioration in the borrower’s collateral position on the respective loans.

The following table represents, by loan portfolio, a summary of changes in the allowance for loan losses for the year ended December 31, 2018 and provides details regarding the balance in the allowance for loan losses and the recorded investment in loans as of December 31, 2018 by impairment evaluation method:

(dollars in thousands)	Commercial Loan Portfolio			Other Loan Portfolio			Total
	Commercial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Lease Financing	
<b>Changes in allowance for loan losses in 2018:</b>							
Beginning balance	\$ 5,256	\$ 5,044	\$ 518	\$ 2,750	\$ 1,344	\$ 1,519	\$ 16,431
Provision for loan losses	4,941	(207)	(227)	(517)	2,156	3,284	9,430
Charge-offs	(1,236)	(492)	—	(361)	(1,876)	(3,024)	(6,989)
Recoveries	563	378	81	169	530	310	2,031
Ending balance	\$ 9,524	\$ 4,723	\$ 372	\$ 2,041	\$ 2,154	\$ 2,089	\$ 20,903
<b>Allowance for loan losses at December 31, 2018 attributable to:</b>							
Loans individually evaluated for impairment	\$ 4,405	\$ 476	\$ 48	\$ 233	\$ —	\$ 330	\$ 5,492
Loans collectively evaluated for impairment	43	47	6	321	45	31	493
Non-impaired loans collectively evaluated for impairment	4,971	3,356	318	1,051	1,926	1,728	13,350
Loans acquired with deteriorated credit quality <sup>(1)</sup>	105	844	—	436	183	—	1,568
Total allowance for loan losses	\$ 9,524	\$ 4,723	\$ 372	\$ 2,041	\$ 2,154	\$ 2,089	\$ 20,903
<b>Recorded investment (loan balance) at December 31, 2018:</b>							
Impaired loans individually evaluated for impairment	\$ 8,520	\$ 23,431	\$ 1,249	\$ 3,929	\$ 5	\$ 668	\$ 37,802
Impaired loans collectively evaluated for impairment	408	437	58	3,341	564	289	5,097
Non-impaired loans collectively evaluated for impairment	797,099	1,596,035	222,591	562,019	610,839	263,094	4,051,677
Loans acquired with deteriorated credit quality <sup>(1)</sup>	4,857	19,252	8,331	8,759	1,776	—	42,975
Total recorded investment (loan balance)	\$ 810,884	\$ 1,639,155	\$ 232,229	\$ 578,048	\$ 613,184	\$ 264,051	\$ 4,137,551

(1) Loans acquired with deteriorated credit quality were originally recorded at fair value at the acquisition date and the risk of credit loss was recognized at that date based on estimates of expected cash flows.

The following table represents, by loan portfolio, a summary of changes in the allowance for loan losses for the year ended December 31, 2017 and provides details regarding the balance in the allowance for loan losses and the recorded investment in loans as of December 31, 2017 by impairment evaluation method:

(dollars in thousands)	Commercial Loan Portfolio			Other Loan Portfolio			Total
	Commercial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Lease Financing	
<b>Changes in allowance for loan losses in 2017:</b>							
Beginning balance	\$ 5,920	\$ 3,225	\$ 345	\$ 2,929	\$ 930	\$ 1,513	\$ 14,862
Provision for loan losses	(118)	7,879	110	1	954	730	9,556
Charge-offs	(737)	(6,552)	—	(698)	(794)	(1,041)	(9,822)
Recoveries	191	492	63	518	254	317	1,835
Ending balance	\$ 5,256	\$ 5,044	\$ 518	\$ 2,750	\$ 1,344	\$ 1,519	\$ 16,431
<b>Allowance for loan losses at December 31, 2017 attributable to:</b>							
Loans individually evaluated for impairment	\$ 221	\$ 281	\$ 5	\$ 302	\$ —	\$ 261	\$ 1,070
Loans collectively evaluated for impairment	305	48	5	264	29	84	735
Non-impaired loans collectively evaluated for impairment	4,230	4,379	504	1,644	1,166	1,174	13,097
Loans acquired with deteriorated credit quality <sup>(1)</sup>	500	336	4	540	149	—	1,529
Total allowance for loan losses	\$ 5,256	\$ 5,044	\$ 518	\$ 2,750	\$ 1,344	\$ 1,519	\$ 16,431
<b>Recorded investment (loan balance) at December 31, 2017:</b>							
Impaired loans individually evaluated for impairment	\$ 1,285	\$ 13,554	\$ 797	\$ 3,700	\$ 4	\$ 568	\$ 19,908
Impaired loans collectively evaluated for impairment	2,818	443	46	2,484	283	778	6,852
Non-impaired loans collectively evaluated for impairment	549,154	1,413,079	199,010	441,418	370,999	203,797	3,177,457
Loans acquired with deteriorated credit quality <sup>(1)</sup>	2,673	12,935	734	5,950	169	—	22,461
Total recorded investment (loan balance)	\$ 555,930	\$ 1,440,011	\$ 200,587	\$ 453,552	\$ 371,455	\$ 205,143	\$ 3,226,678

(1) Loans acquired with deteriorated credit quality were originally recorded at fair value at the acquisition date and the risk of credit loss was recognized at that date based on estimates of expected cash flows.

**Note 6 – Premises and Equipment, Net**

A summary of premises and equipment as of December 31, 2018 and 2017 is as follows:

(dollars in thousands)	2018	2017
Land	\$ 20,231	\$ 16,109
Buildings and improvements	76,141	63,837
Furniture and equipment	29,858	25,843
Total	126,230	105,789
Accumulated depreciation	(31,390)	(29,627)
Premises and equipment, net	\$ 94,840	\$ 76,162

Depreciation expense for the years ended December 31, 2018, 2017 and 2016 was \$6.2 million, \$5.0 million, and \$5.1 million, respectively.



**Note 7 – Mortgage Servicing Rights**

The Company serviced commercial FHA mortgage loans for others with unpaid principal balances of approximately \$3.98 billion at December 31, 2018 and 2017. Changes in our commercial FHA mortgage servicing rights were as follows for the years ended December 31, 2018, 2017 and 2016:

(dollars in thousands)	2018	2017	2016
<b>Mortgage servicing rights:</b>			
Balance, beginning of period	\$ 55,714	\$ 52,006	\$ 47,589
Originated servicing	3,174	6,287	6,805
Amortization	(2,636)	(2,579)	(2,388)
Balance, end of period	56,252	55,714	52,006
<b>Valuation allowances:</b>			
Balance, beginning of period	3,254	1,712	—
Additions	931	1,542	1,920
Reductions	(1,380)	—	(208)
Balance, end of period	2,805	3,254	1,712
Mortgage servicing rights, net	\$ 53,447	\$ 52,460	\$ 50,294
<b>Fair value:</b>			
At beginning of period	\$ 52,460	\$ 50,294	\$ 47,589
At end of period	\$ 53,447	\$ 52,460	\$ 50,294

The following table is a summary of key assumptions, representing both general economic and other published information and the weighted average characteristics of the commercial portfolio, used in the valuation of servicing rights at December 31, 2018 and 2017. Assumptions used in the prepayment rate consider many factors as appropriate, including lockouts, balloons, prepayment penalties, interest rate ranges, delinquencies and geographic location. The discount rate is based on an average pre-tax internal rate of return utilized by market participants in pricing the servicing portfolio. Significant increases or decreases in any one of these assumptions would result in a significantly lower or higher fair value measurement.

	Servicing Fee	Interest Rate	Remaining Years to Maturity	Prepayment Rate	Servicing Cost	Discount Rate
<b>December 31, 2018:</b>						
Commercial FHA mortgage loans	0.13 %	3.67 %	30.1	8.24 %	\$ 1,000	10 - 14 %
<b>December 31, 2017:</b>						
Commercial FHA mortgage loans	0.12 %	3.67 %	30.3	8.27 %	\$ 1,000	10 - 14 %

We recognize revenue from servicing commercial FHA and residential mortgages as earned based on the specific contractual terms. This revenue, along with amortization of and changes in impairment on servicing rights, is reported in commercial FHA revenue and residential mortgage banking revenue in the consolidated statements of income. Mortgage servicing rights do not trade in an active market with readily observable prices. The fair value of mortgage servicing rights and their sensitivity to changes in interest rates is influenced by the mix of the servicing portfolio and characteristics of each segment of the portfolio. The Company's servicing portfolio consists of the distinct portfolios of government-insured residential and commercial mortgages and conventional residential mortgages. The fair value of our servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, costs to service, contractual servicing fee income, ancillary income, late fees, replacement reserves and other economic factors that are determined based on current market conditions.

At December 31, 2018 and 2017, the Company serviced residential mortgage loans for others with unpaid principal balances of approximately \$897.6 million and \$1.99 billion, respectively. During the year ended December 31, 2017, the Company recognized a \$4.1 million loss to reflect certain residential mortgage servicing rights classified as held for sale at the lower of their carrying value or fair value less estimated costs to sell. On January 2, 2018, the Company sold its \$10.2 million of residential mortgage servicing rights held for sale. Subsequent to this sale, the Company transferred all remaining residential mortgage servicing rights to mortgage servicing rights held for sale. At

December 31, 2018, residential mortgage servicing rights of \$3.5 million are reflected in the consolidated balance sheet as mortgage servicing rights held for sale.

**Note 8 – Goodwill and Intangible Assets**

At December 31, 2018 and 2017, goodwill totaled \$164.7 million and \$98.6 million, respectively, reflecting an increase as a result of the Alpine acquisition on February 28, 2018, as further discussed in Note 2 to the consolidated financial statements. Goodwill represents the amount by which the cost of an acquisition exceeded fair value of net assets acquired in connection with the purchase of another financial institution. Goodwill is tested for impairment at least annually or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company performed its most recent annual goodwill impairment test as of September 30, 2018 and concluded that no impairment existed as of that date.

The following table summarizes the carrying amount of goodwill by segment at December 31, 2018 and 2017.

(dollars in thousands)	2018	2017
Banking	\$ 149,035	\$ 82,986
Commercial FHA origination and servicing	10,892	10,892
Wealth management	4,746	4,746
Total goodwill	<u>\$ 164,673</u>	<u>\$ 98,624</u>

The Company’s intangible assets, consisting of core deposit and customer relationship intangibles, as of December 31, 2018 and 2017 are summarized as follows:

(dollars in thousands)	2018			2017		
	Gross Carrying Amount	Accumulated Amortization	Total	Gross Carrying Amount	Accumulated Amortization	Total
Core deposit intangibles	\$ 52,712	\$ (24,803)	\$ 27,909	\$ 31,612	\$ (18,943)	\$ 12,669
Customer relationship intangibles	13,771	(4,304)	9,467	7,471	(3,208)	4,263
Total intangible assets	<u>\$ 66,483</u>	<u>\$ (29,107)</u>	<u>\$ 37,376</u>	<u>\$ 39,083</u>	<u>\$ (22,151)</u>	<u>\$ 16,932</u>

In conjunction with the acquisition of Alpine on February 28, 2018, we recorded \$21.1 million of core deposit intangibles and \$6.3 million of customer relationship intangibles, which are both being amortized on an accelerated basis over an estimated useful life of 13 years, as further discussed in Note 2 to the consolidated financial statements.

Amortization of intangible assets was \$7.0 million, \$3.3 million and \$2.1 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Estimated amortization expense for future years is as follows:

(dollars in thousands)	Amount
Year ending December 31,	
2019	\$ 6,716
2020	5,792
2021	5,032
2022	4,326
2023	3,620
Thereafter	11,890
Total	<u>\$ 37,376</u>

**Note 9 – Derivative Instruments**

As part of the Company’s overall management of interest rate sensitivity, the Company utilizes derivative instruments to minimize significant, unanticipated earnings fluctuations caused by interest rate volatility, including

interest rate lock commitments, forward commitments to sell mortgage-backed securities and interest rate swap contracts.

### ***Interest Rate Lock Commitments / Forward Commitments to Sell Mortgage-Backed Securities***

The Company issues interest rate lock commitments on originated fixed-rate commercial and residential real estate loans to be sold. The interest rate lock commitments and loans held for sale are hedged with forward contracts to sell mortgage-backed securities. The fair value of the interest rate lock commitments and forward contracts to sell mortgage-backed securities are included in other assets in the consolidated balance sheets. Changes in the fair value of derivative financial instruments are recognized in commercial FHA revenue and residential mortgage banking revenue in the consolidated statements of income.

The following tables summarize the interest rate lock commitments and forward commitments to sell mortgage-backed securities held by the Company, their notional amount and estimated fair values at December 31, 2018 and 2017:

(dollars in thousands)	Notional Amount		Fair Value Gain	
	2018	2017	2018	2017
<b>Derivative Instruments (included in Other Assets):</b>				
Interest rate lock commitments	\$ 264,710	\$ 345,152	\$ 4,492	\$ 6,331
Forward commitments to sell mortgage-backed securities	276,871	372,824	—	31
Total	<u>\$ 541,581</u>	<u>\$ 717,976</u>	<u>\$ 4,492</u>	<u>\$ 6,362</u>

(dollars in thousands)	Notional Amount		Fair Value Loss	
	2018	2017	2018	2017
<b>Derivative Instruments (included in Other Liabilities):</b>				
Forward commitments to sell mortgage-backed securities	\$ 54	\$ —	\$ —	\$ —

Net losses recognized on derivative instruments were \$2.0 million and \$16,000 for the years ended December 31, 2018 and December 31, 2017, respectively. Net gains recognized on derivative instruments were \$351,000 for the year ended December 31, 2016. Net gains or losses on derivative instruments were recognized in commercial FHA revenue and residential mortgage banking revenue in the consolidated statements of income.

### ***Interest Rate Swap Contracts***

The Company entered into interest rate swap contracts sold to commercial customers who wish to modify their interest rate sensitivity. These swaps are offset by contracts simultaneously purchased by the Company from other financial dealer institutions with mirror-image terms. Because of the mirror-image terms of the offsetting contracts, in addition to collateral provisions which mitigate the impact of non-performance risk, changes in the fair value subsequent to initial recognition have a minimal effect on earnings. These derivative contracts do not qualify for hedge accounting.

The notional amounts of these customer derivative instruments and the offsetting counterparty derivative instruments were \$9.5 million and \$10.0 million at December 31, 2018 and 2017, respectively. The fair value of the customer derivative instruments and the offsetting counterparty derivative instruments was \$145,000 and \$17,000 at December 31, 2018 and 2017, respectively, which are included in other assets and other liabilities, respectively, on the consolidated balance sheets.

**Note 10 – Deposits**

The following table summarizes the classification of deposits as of December 31, 2018 and 2017:

(dollars in thousands)	2018	2017
Noninterest-bearing demand	\$ 972,164	\$ 724,443
Interest-bearing:		
Checking	1,002,275	785,934
Money market	862,171	646,426
Savings	442,132	281,212
Time	795,428	693,074
Total deposits	<u>\$ 4,074,170</u>	<u>\$ 3,131,089</u>

Included in time deposits are time certificates of \$250,000 or more and brokered certificates of deposits of \$76.0 million and \$161.6 million as of December 31, 2018, respectively, and \$69.9 million and \$190.3 million as of December 31, 2017, respectively.

Investment securities with a carrying amount of \$182.4 million and \$116.0 million were pledged for public deposits at December 31, 2018 and 2017, respectively. Standby letters of credit issued by the FHLB on our behalf of \$120.0 million were pledged for public deposits at December 31, 2018 and 2017.

As of December 31, 2018, the scheduled maturities of time deposits are as follows:

(dollars in thousands)	Amount
<b>Year ending December 31,</b>	
2019	\$ 523,651
2020	135,754
2021	97,871
2022	22,183
2023	15,968
Thereafter	1
Total	<u>\$ 795,428</u>

**Note 11 – Short-Term Borrowings**

The following table presents the distribution of short-term borrowings and related weighted average interest rates for each of the years ended December 31, 2018 and 2017:

(dollars in thousands)	Repurchase Agreements	
	2018	2017
Outstanding at period-end	\$ 124,235	\$ 156,126
Average amount outstanding	138,135	163,461
Maximum amount outstanding at any month end	173,387	196,278
Weighted average interest rate:		
During period	0.51 %	0.23 %
End of period	0.71 %	0.28 %

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction, which represents the amount of the Bank's obligation. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. Investment securities with a carrying amount of \$132.2 million and \$157.2 million at December 31, 2018 and 2017, respectively, were pledged for securities sold under agreements to repurchase.

The Company had lines of credit of \$56.8 million and \$32.5 million at December 31, 2018 and 2017, respectively, from the Federal Reserve Discount Window. The lines are collateralized by a collateral agreement with respect to a pool of commercial real estate loans totaling \$67.6 million and \$36.5 million at December 31, 2018 and 2017, respectively. There were no outstanding borrowings at December 31, 2018 and 2017.

At December 31, 2018, the Company had federal funds lines of credit totaling \$45.0 million. These lines of credit were unused at December 31, 2018.

**Note 12 – FHLB Advances and Other Borrowings**

The following table summarizes our FHLB advances and other borrowings as of December 31, 2018 and 2017:

(dollars in thousands)	2018	2017
<b>Midland States Bancorp, Inc.</b>		
Term loan - variable interest rate equal to LIBOR plus 2.25%, which was 4.63% and 3.63% at December 31, 2018 and 2017, respectively – maturing May 25, 2020	\$ 32,840	\$ 37,113
Series G redeemable preferred stock - 181 shares at \$1,000 per share	181	181
<b>Midland States Bank</b>		
FHLB advances – fixed rate, fixed term of \$87.7 million and \$145.0 million, at rates averaging 2.35% and 1.35% at December 31, 2018 and 2017, respectively – maturing through February 2023, and putable fixed rate of \$520.0 million and \$305.0 million at rates averaging 2.09% and 1.29% at December 31, 2018 and 2017, respectively, – maturing through August 2025 with call provisions through August 2021	607,610	450,137
FHLB advances – variable rate, fixed term, at rates averaging 1.20% at December 31, 2017 – maturing through March 2018	—	9,000
Other	—	5
Total FHLB advances and other borrowings	<u>\$ 640,631</u>	<u>\$ 496,436</u>

In May 2017, the Company entered into a loan agreement with another bank for a revolving line of credit in the original principal amount of up to \$10.0 million and a term loan in the original principal amount of \$40.0 million. The term loan matures on May 25, 2020 and pays a variable rate of interest equal to one-month LIBOR plus 225 basis points. Beginning September 1, 2017, the Company was required to begin making quarterly principal and interest payments on the term loan of \$1.4 million with the remaining principal and any unpaid interest due at maturity. The loan is unsecured with a negative pledge of shares of the Company’s common stock. The loan agreement contains financial covenants that require the Company to maintain a minimum total capital to risk-weighted assets ratio, a minimum adjusted loan loss reserves to nonperforming loans ratio, a minimum fixed charge coverage ratio and a maximum percentage of nonperforming assets to tangible capital. At December 31, 2018, the Company was in compliance with or has obtained waivers for each of these financial covenants.

In conjunction with the acquisition of Centruie on June 9, 2017, as further discussed in Note 2 to the consolidated financial statements, each share of Centruie’s Series B preferred stock was converted into the right to receive a share of a newly created series of Series G preferred stock of the Company, and was recorded at fair value of \$181,000 at the time of acquisition.

The Company’s advances from the FHLB are collateralized by a blanket collateral agreement of qualifying mortgage and home equity line of credit loans and certain commercial real estate loans totaling approximately \$2.22 billion and \$1.86 billion at December 31, 2018 and 2017, respectively.

Contractual payments over the next five years for FHLB advances and other borrowings are as follows:

(dollars in thousands)	Amount
2019	\$ 73,074
2020	30,953
2021	5,814
2022	153,210
2023	267,580
Thereafter	110,000
Total	<u>\$ 640,631</u>

**Note 13 – Subordinated Debt**

The following table summarizes the Company’s subordinated debt as of December 31, 2018 and 2017:

(dollars in thousands)	2018	2017
Subordinated debt issued June 2015 – fixed interest rate of 6.00% for the first five years through June 2020 and a variable interest rate equivalent to three month LIBOR plus 4.35% thereafter, \$40,325 maturing June 18, 2025	\$ 39,871	\$ 39,800
Subordinated debt issued June 2015 – fixed interest rate of 6.50%, \$15,000 maturing June 18, 2025	14,831	14,805
Subordinated debt issued October 2017 - fixed interest rate of 6.25% for the first five years through October 2022 and a variable interest rate equivalent to three month LIBOR plus 4.23% thereafter, \$40,000 maturing October 15, 2027	39,432	39,367
Total subordinated debt	<u>\$ 94,134</u>	<u>\$ 93,972</u>

In June 2015, the Company issued \$55.3 million of subordinated debt in a private placement. The transaction was structured in two tranches: (1) \$40.3 million, maturing on June 18, 2025 with a redemption option on or after June 18, 2020, with a fixed rate of interest of 6.00% for the first five years, payable semiannually in arrears beginning December 18, 2015, and a floating rate of interest equivalent to the three-month LIBOR plus 435 basis points thereafter, payable quarterly beginning on September 18, 2020; and (2) \$15.0 million, maturing on June 18, 2025, with a fixed rate of interest of 6.50%, payable semiannually in arrears beginning December 18, 2015. The value of the subordinated debentures was reduced by \$0.9 million with the recording of debt issuance costs associated with the issuance of the subordinated debentures, which are being amortized on a straight line basis through maturity of the subordinated notes. The subordinated debentures may be included in Tier 2 capital (with certain limitations applicable) under current regulatory guidelines and interpretations.

On October 13, 2017, the Company issued, through a private placement, \$40.0 million aggregate principal amount of subordinated debentures with a maturity date of October 15, 2027. The subordinated debentures bear a fixed rate of interest of 6.25% for the first five years, payable semiannually in arrears beginning April 15, 2018, and a floating rate of interest equal to the three-month LIBOR plus 422.9 basis points thereafter, payable quarterly in arrears beginning January 15, 2023. The subordinated debentures will be redeemable by the Company, in whole or in part, on or after October 15, 2022, and are not subject to redemption at the option of the holders. The value of the subordinated debentures was reduced by approximately \$0.6 million related to debt issuance costs, which are being amortized on a straight line basis through the maturity of the subordinated debentures. The subordinated debenture issues may be included in Tier 2 capital (with certain limitations applicable) under current regulatory guidelines and interpretations.

**Note 14 – Trust Preferred Debentures**

The following table summarizes the Company’s trust preferred debentures as of December 31, 2018 and 2017:

(dollars in thousands)	2018	2017
Midland States Preferred Securities Trust – variable interest rate equal to LIBOR plus 2.75%, which was 5.23% and 4.11% at December 31, 2018 and 2017, respectively – \$10,310 maturing April 23, 2034	\$ 10,272	\$ 10,269
Grant Park Statutory Trust I – variable interest rate equal to LIBOR plus 2.85%, which was 5.37% and 4.23%, at December 31, 2018 and 2017, respectively – \$3,093 maturing January 23, 2034	2,209	2,151
Love Savings/Heartland Capital Trust III – variable interest rate equal to LIBOR plus 1.75%, which was 4.54% and 3.34% at December 31, 2018 and 2017, respectively – \$20,619 maturing December 31, 2036	14,074	13,911
Love Savings/Heartland Capital Trust IV – variable interest rate equal to LIBOR plus 1.47%, which was 4.21% and 2.98% at December 31, 2018 and 2017, respectively – \$20,619 maturing September 6, 2037	13,249	13,084
Centrue Statutory Trust II - variable interest rate equal to LIBOR plus 2.65%, which was 5.44% and 4.25% at December 31, 2018 and 2017, respectively - \$10,310 maturing June 17, 2034	7,990	7,915
Total trust preferred debentures	<u>\$ 47,794</u>	<u>\$ 47,330</u>

On March 26, 2004, Midland States Preferred Securities Trust (“Midland Trust”), a statutory trust under the Delaware Statutory Trust Act, was formed by the Company. The Midland Trust issued a pool of \$10.0 million of floating rate Cumulative Trust Preferred Debentures with a liquidation amount of \$1,000 per security. The Company

issued \$10.0 million of subordinated debentures to the Midland Trust in exchange for ownership of all the common securities of the Midland Trust. The Company is not considered the primary beneficiary of this trust; therefore, the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability. The Company's investment in the common stock of the trust was \$310,000 and is included in other assets.

In conjunction with the acquisition of Grant Park Bancshares, Inc. on June 5, 2013, the Company assumed \$3.0 million of subordinated debentures that were recorded at a fair value of \$1.8 million at the time of acquisition. On December 19, 2003, the Grant Park Statutory Trust I ("Grant Park Trust") issued 3,000 shares of preferred securities with a liquidation amount of \$1,000 per security. Grant Park issued \$3.0 million of subordinated debentures to the Grant Park Trust in exchange for ownership of all the common securities of the trust. The Company is not considered the primary beneficiary of the Grant Park Trust; therefore, the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability. The Company's investment in the common stock of the trust was \$93,000 and is included in other assets.

In conjunction with the acquisition of Love Savings Holding Company ("LSHC") on December 31, 2014, the Company assumed \$40.0 million of subordinated debentures that were recorded at a fair value of \$26.1 million at the time of acquisition. On November 30, 2006, the Love Savings/Heartland Capital Trust III ("LSHC Trust III") issued 20,000 shares of capital securities with a liquidation amount of \$1,000 per security. LSHC issued \$20.0 million of subordinated debentures to LSHC Trust III in exchange for ownership of all the common securities of the trust. On June 6, 2007, the Love Savings/Heartland Capital Trust IV ("LSHC Trust IV") issued 20,000 shares of capital securities with a liquidation amount of \$1,000 per security. LSHC issued \$20.0 million of subordinated debentures to LSHC Trust IV in exchange for ownership of all the common securities of the trust. The Company is not considered the primary beneficiary of LSHC Trust III or LSHC Trust IV; therefore, the trusts are not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability. The Company's investment in the common stock of the trusts was \$1.2 million and is included in other assets.

In conjunction with the acquisition of Centruie on June 9, 2017, as further discussed in Note 2 to the consolidated financial statements, the Company assumed \$10.0 million of subordinated debentures that were recorded at a fair value of \$7.6 million at the time of acquisition. In April 2004, the Centruie Statutory Trust II ("Centruie Trust II") issued 10,000 shares of preferred securities with a liquidation amount of \$1,000 per preferred security. Centruie issued \$10.0 million of subordinated debentures to Centruie Trust II in exchange for ownership of all the common securities of the trust. The Company is not considered the primary beneficiary of Centruie Trust II; therefore, the trust is not consolidated in the Company's consolidated financial statements, but rather the subordinated debentures are shown as a liability, and the Company's investment in the common stock of Centruie Trust II of \$310,000 is included in other assets.

For all of the debentures mentioned above, interest is payable quarterly. The debentures and the common securities issued by each of the trusts are redeemable in whole or in part on dates each quarter at the redemption price plus interest accrued to the redemption date, as specified in the trust indenture document. The debentures are also redeemable in whole or in part from time to time upon the occurrence of "special events" defined within the indenture document. Subject to certain exceptions and limitations, the Company may, from time to time, defer subordinated debenture interest payments, which would result in a deferral of distribution payments on the related debentures, and, with certain exceptions, prevent the Company from declaring or paying cash distributions on common stock or debt securities that rank *pari passu* or junior to the subordinated debenture.

**Note 15 – Income Taxes**

The components of income taxes for the years ended December 31, 2018, 2017 and 2016 were as follows:

<b>(dollars in thousands)</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>Federal:</b>			
Current	\$ 55	\$ (696)	\$ 1,718
Deferred	6,748	11,632	11,381
<b>State:</b>			
Current	807	(921)	2,630
Deferred	3,774	400	3,160
Total income tax expense	<u>\$ 11,384</u>	<u>\$ 10,415</u>	<u>\$ 18,889</u>

The Company's income tax expense differed from the statutory federal rate of 21% for the year ended December 31, 2018 and 35% for the years ended December 31, 2017 and 2016 as follows:

<b>(dollars in thousands)</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Expected income taxes	\$ 10,665	\$ 9,244	\$ 17,648
Less income tax effect of:			
Tax exempt interest, net	(1,441)	(1,635)	(1,637)
State tax, net of federal benefit	4,028	(110)	3,132
Increase in cash surrender value of life insurance policies	(854)	(969)	(1,007)
Equity-based compensation benefit	(62)	(1,297)	(366)
Non-deductible transaction costs	71	389	—
Valuation allowance	(409)	(229)	631
Effect of federal rate change enacted in 2017	—	4,540	—
Other	(614)	482	488
Actual income tax expense	<u>\$ 11,384</u>	<u>\$ 10,415</u>	<u>\$ 18,889</u>



Deferred tax assets, net in the accompanying consolidated balance sheets as of December 31, 2018 and 2017 include the following amounts of deferred tax assets and liabilities:

(dollars in thousands)	2018	2017
<b>Assets:</b>		
Allowance for loan losses	\$ 5,748	\$ 4,405
Deferred compensation	2,158	1,896
Loans	6,579	3,896
Write-down of other real estate owned	563	776
Tax credits	1,041	1,501
Nonaccrual interest	730	708
Unrealized loss on securities	802	—
Stock compensation	700	907
Deferred loan fees, net of costs	—	133
Net operating losses	17,417	20,097
Accrued litigation	179	101
Allowance for repurchase reserves	135	100
Allowance for unfunded commitments	319	180
Fair value adjustment on investments	1,330	—
Charitable contributions	202	58
Other, net	720	324
Deferred tax assets	38,623	35,082
Valuation allowance	—	(409)
Deferred tax assets, net of valuation allowance	38,623	34,673
<b>Liabilities:</b>		
Premises and equipment	3,522	1,657
Unrealized gain on securities	—	412
Mortgage servicing rights	11,460	11,424
Fair value adjustment on trust preferred debentures	4,694	4,700
Federal Home Loan Bank stock dividends	391	310
Deferred loan costs, net of fees	1,495	—
Intangible assets	8,741	2,729
Accounting method changes	74	399
Prepaid expenses	708	796
Software development costs	1,667	—
Leased equipment	4,351	—
Other, net	269	222
Deferred tax liabilities	37,372	22,649
Deferred tax assets, net	\$ 1,251	\$ 12,024

At December 31, 2018 and 2017, the accumulation of prior year's earnings representing tax bad debt deductions was approximately \$3.1 million for both years. If these tax bad debt reserves were charged for losses other than bad debt losses, the Company would be required to recognize taxable income in the amount of the charge. It is not expected that such tax-restricted retained earnings will be used in a manner that would create federal income tax liabilities.

The Company had \$62.6 million of federal net operating loss carryforwards expiring 2021 through 2034, \$53.4 million of Illinois post-apportioned net operating loss carryforwards expiring 2022 through 2026, and \$62.6 million of Missouri pre-apportioned net operating loss carryforwards expiring 2021 through 2034, at December 31, 2018. The utilization of the federal and Missouri net operating losses are subject to the limitations of IRC Section 382.

The Company has a federal alternative minimum tax credit carryforward of \$3.6 million that can be carried forward indefinitely and became a refundable credit with the enactment of the Tax Act on December 22, 2017. As of December 31, 2018 and 2017 this credit is not reflected in deferred tax assets and is presented in income taxes receivable.

The Company has state tax credit carryforwards of \$1.0 million with a five year carryforward period, and expiring between 2019 and 2023. Any amounts that are expected to expire before being fully utilized have been accounted for through a valuation allowance as discussed below.

As a result of the enactment of the Tax Act on December 22, 2017, the Company was required to write down deferred tax assets by \$4.5 million. Following the guidance of SEC Staff Accounting Bulletin No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act* (SAB 118), the write down of the deferred tax assets was determined using reasonable estimates for certain effects of tax reform, and the Company recorded the amount of the write down as a provisional amount at December 31, 2017. The final analysis of the impact of the Tax Act was completed once the Company finalized its 2017 tax returns in the third quarter of 2018. The results of this analysis yielded an immaterial true-up to the \$4.5 million provisional estimate previously recorded in 2017.

We had no unrecognized tax benefits as of December 31, 2018 and 2017, and did not recognize any increase of unrecognized benefits during 2018 relative to any tax positions taken during the year.

Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in other income or expense; no such accruals existed as of December 31, 2018 and 2017.

Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character within the carryback or carryforward period available under the tax law. All available evidence, both positive and negative, should be considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. At December 31, 2017, the Company concluded, based on all available evidence, a valuation allowance was needed for the Company's deferred tax asset related to state tax credit carryforwards. A valuation allowance in the amount of \$409,000 was established for the state tax credit carryforwards at December 31, 2017. During 2018 the valuation allowance for the state tax credit carryforwards was released due to a one-time restructuring event that created taxable income that was offset by the utilization of the state tax credits prior to their expiration. For the Company's remaining deferred tax assets, based on our taxpaying history and estimates of taxable income over the years in which the items giving rise to the deferred tax assets are deductible, management believes it is more likely than not that we will realize the benefits of these deductible differences.

The Company is subject to U.S. federal income tax as well as income tax of various states. Years that remain open for potential review by the Internal Revenue Service are 2015 through 2017 and for state taxing authorities are 2014 through 2017.

#### **Note 16 – Retirement Plans**

We sponsor the Midland States Bank 401(k) Profit Sharing Plan which provides retirement benefits to substantially all of our employees. There were no employer discretionary profit sharing contributions made to the 401(k) plan in 2018, 2017 and 2016. The 401(k) component of the plan allows participants to defer a portion of their compensation ranging from 1% to 100%. Such deferrals accumulate on a tax deferred basis until the employee withdraws the funds. The Company matches 50% of employee contributions up to 6% of their compensation. Total expense recorded for the Company match was \$1.8 million, \$1.2 million and \$1.2 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Certain directors and executive officers participate in a deferred compensation arrangement. We match 25% of the amount deferred by directors who defer all of their director fees into a Company stock unit account. At December 31, 2018 and 2017, the accrued liability for these arrangements totaled \$4.2 million and \$3.8 million, respectively, and was reflected in other liabilities in the consolidated balance sheets. Expenses associated with these arrangements were \$754,000, \$659,000 and \$605,000 for the years ended December 31, 2018, 2017 and 2016, respectively. During the years ended December 31, 2018, 2017 and 2016, there were distributions made of \$356,000, \$100,000 and \$126,000, respectively.

In November 2015, the Company entered into a supplemental retirement agreement with its former Chief Executive Officer ("CEO"). The former CEO is eligible to receive supplemental retirement payments in each of 2019, 2020 and 2021 equal to 50%, 40% and 30%, respectively, of his final salary on December 31, 2018 (retirement date). The Company expensed \$282,000, \$210,000 and \$219,000 for the years ended December 31, 2018, 2017 and 2016, respectively, for this arrangement.

Midland participates in the Pentegra Defined Benefit Plan for Financial Institutions, a noncontributory defined benefit pension plan for certain former employees of Heartland Bank who have met prescribed eligibility requirements. The multiple-employer plan operates as a single plan under Internal Revenue code 413(c) and, as a result, all of the

amounts contributed by the participating institutions are maintained in the aggregate. The plan is funded based on an annual valuation performed by the plan administrator. Benefits under the plan were frozen in 2004. The funded status of the plan (market value of assets divided by funding target) was 121.96% as of July 1, 2018, the latest actuarial valuation date. Future costs for administration, shortfalls in funds to maintain the frozen level of benefit coverage and differences of actuarial assumptions related to the frozen benefits will be expensed as incurred. The minimum required contribution for these costs in 2018 and 2017 was \$122,000 and \$121,000, respectively.

### Note 17 – Stock Based Compensation

On October 18, 2010, the board of directors approved the Midland States Bancorp, Inc. 2010 Long-Term Incentive Plan (“2010 Incentive Plan”). The 2010 Incentive Plan was amended and restated effective February 2, 2016, which made available 2,000,000 shares (the initial 1,000,000 of which may be granted as incentive stock options) to be issued to selected employees and directors of, and service providers to, the Company or its subsidiaries. The granting of awards under this plan can be in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other awards. The awards are granted by the compensation committee, which is comprised of members of the board of directors.

Stock Option awards were granted during the years ended December 31, 2017 and 2016. The fair value of each grant is estimated at the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2017	2016
Dividend yield	2.50 %	3.00 %
Expected volatility	16.63	16.98
Risk free interest rate	2.12	1.64
Expected life	6.25 years	6.25 years

The summary of our stock option activity during the years ended December 31, 2018 and 2017 is as follows:

	2018			2017		
	Shares	Weighted average exercise price	Weighted average remaining contractual life	Shares	Weighted average exercise price	Weighted average remaining contractual life
Options outstanding, beginning of year	1,148,537	\$ 19.39		1,319,259	\$ 18.73	
Options granted	—	—		31,259	32.89	
Options exercised	(108,344)	16.42		(179,760)	16.02	
Options forfeited	(34,049)	26.27		(22,221)	26.08	
Options outstanding, end of year	<u>1,006,144</u>	\$ 19.48	4.9 years	<u>1,148,537</u>	\$ 19.39	5.8 years
Options exercisable	885,817	\$ 18.53	4.6 years	673,706	\$ 17.55	4.6 years
Options vested and expected to vest	991,774	\$ 19.38	4.9 years	1,088,853	\$ 19.27	5.7 years

The aggregate intrinsic value of options outstanding and exercisable as of December 31, 2018 was \$3.8 million and \$3.8 million, respectively. As of December 31, 2018, there was \$311,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under our stock option plans. This cost is expected to be recognized over a period of 1.7 years. The weighted average fair value of options granted during the years ended December 31, 2017 and 2016 was \$4.33 and \$2.94, respectively.

The total intrinsic value and cash received from options exercised under all share-based payment arrangements was \$1.6 million and \$1.8 million, respectively, for the year ended December 31, 2018, \$2.3 million and \$2.9 million, respectively, for the year ended December 31, 2017, and \$971,000 and \$890,000, respectively, for the year ended December 31, 2016.

The following table summarizes information about the Company's nonvested stock option activity for 2018:

<b>Stock Options</b>	<b>Shares</b>	<b>Weighted average grant date fair value</b>
Nonvested at December 31, 2017	474,831	\$ 2.83
Granted	—	—
Vested	(324,508)	2.72
Forfeited	(29,996)	2.91
Nonvested at December 31, 2018	120,327	\$ 3.11

In 2018 and 2017, the Company granted 138,683 and 70,951 shares of restricted stock awards, respectively. These awards have a vesting period of four years. Compensation expense is recognized over the vesting period of the award based on the fair value of the stock at the date of issue. Also, in 2017, the Company granted 12,965 restricted stock unit awards that may be settled in cash or stock, at the election of the recipient. These awards had a vesting period of one year. They were classified as liability awards and measured at each financial reporting date until settled.

A summary of the activity for restricted stock awards and restricted stock unit awards for the year follows:

	<b>Number outstanding</b>	<b>Weighted average grant date fair value</b>
Nonvested at December 31, 2017	149,368	\$ 28.83
Granted during the year	138,683	28.47
Vested during the year	(56,907)	27.95
Forfeited during the year	(33,427)	30.17
Nonvested at December 31, 2018	197,717	\$ 28.61

As of December 31, 2018, there was \$5.3 million of total unrecognized compensation cost related to the nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted average period of 3.3 years.

The weighted average grant date fair value for restricted stock awards was \$28.47, \$31.03 and \$27.38 during the years ended December 31, 2018, 2017 and 2016, respectively.

Compensation cost that has been charged against income for these plans was \$1.8 million, \$1.8 million and \$1.1 million for 2018, 2017 and 2016, respectively.

## **Note 18 – Preferred Stock**

### *Series G Preferred Stock*

In conjunction with the acquisition of Centruie on June 9, 2017, as discussed in Note 2 to the consolidated financial statements, each share of Centruie's Series B preferred stock was converted into the right to receive a share of a newly created series of Series G preferred stock of the Company, which are shown in FHLB advances and other borrowings in Note 12 to the consolidated financial statements. Preferential cumulative cash dividends are payable quarterly at an annual rate of \$60.00 per share. Dividends accrue on each share of Series G preferred stock from the date of issuance and from day to day, thereafter, whether or not earned or declared.

### *Fixed Rate Non-Voting Perpetual Non-Cumulative Preferred Stock, Series H*

In conjunction with the acquisition of Centruie on June 9, 2017, as discussed in Note 2 to the consolidated financial statements, each share of Centruie's Series D preferred stock was converted into the right to receive a share of a newly created series of Series H preferred stock of the Company, and was recorded at fair value of \$3.1 million at the time of acquisition. Dividends are payable at a fixed rate of 12.5% per annum, payable quarterly and are non-cumulative. No dividends may be paid on shares of common stock, shares of preferred stock that rank junior to Series H preferred stock (other than dividends payable solely in shares of common stock), or shares of preferred stock that rank on parity with Series H preferred stock, if a dividend is not paid in full on the Series H preferred stock, for a period of three

calendar quarters from the date of the missing dividend payment date. The Company has the option to redeem, in whole or in part, the shares of Series H preferred stock at any time after July 29, 2019. The per share price payable by the Company for such shares of Series H preferred stock will be equal to \$1,000 per share, plus any accrued but unpaid dividends.

### Note 19 – Earnings Per Share

Earnings per share are calculated utilizing the two-class method. Basic earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of common shares outstanding. Diluted earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of shares adjusted for the dilutive effect of common stock awards. The diluted earnings per share computation for the years ended December 31, 2018, 2017 and 2016 excluded antidilutive stock options of 31,259, 662 and 114,648, respectively, because the exercise prices of these stock options exceeded the average market prices of the Company's common shares for those respective years. Presented below are the calculations for basic and diluted earnings per common share for the years ended December 31, 2018, 2017 and 2016:

<b>(dollars in thousands, except per share data)</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net income	\$ 39,421	\$ 16,056	\$ 31,542
Preferred stock dividends	(330)	(184)	—
Preferred stock, premium amortization	189	101	—
Net income available to common shareholders equity	39,280	15,973	31,542
Common shareholder dividends	(19,838)	(13,922)	(9,797)
Unvested restricted stock award dividends	(139)	(86)	(56)
Undistributed earnings to unvested restricted stock awards	(123)	(11)	(110)
Undistributed earnings to common shareholders	<u>\$ 19,180</u>	<u>\$ 1,954</u>	<u>\$ 21,579</u>
<b>Basic</b>			
Distributed earnings to common shareholders	\$ 19,838	\$ 13,922	\$ 9,797
Undistributed earnings to common shareholders	19,180	1,954	21,579
Total common shareholders earnings, basic	<u>\$ 39,018</u>	<u>\$ 15,876</u>	<u>\$ 31,376</u>
<b>Diluted</b>			
Distributed earnings to common shareholders	\$ 19,838	\$ 13,922	\$ 9,797
Undistributed earnings to common shareholders	19,180	1,954	21,579
Total common shareholders earnings	39,018	15,876	31,376
Add back:			
Undistributed earnings reallocated from unvested restricted stock awards	2	—	2
Total common shareholders earnings, diluted	<u>\$ 39,020</u>	<u>\$ 15,876</u>	<u>\$ 31,378</u>
Weighted average common shares outstanding, basic	23,130,475	17,781,631	14,130,552
Options and warrants	418,550	501,583	298,287
Weighted average common shares outstanding, diluted	<u>23,549,025</u>	<u>18,283,214</u>	<u>14,428,839</u>
Basic earnings per common share	\$ 1.69	\$ 0.89	\$ 2.22
Diluted earnings per common share	1.66	0.87	2.17

### Note 20 – Capital Requirements

The Company's primary source of cash is dividends received from the Bank. The Bank is restricted by Illinois law and regulations of the Illinois Department of Financial and Professional Regulation and the FDIC as to the maximum amount of dividends the Bank can pay to us. As a practical matter, the Bank restricts dividends to a lesser amount because of the need to maintain an adequate capital structure.

We are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our consolidated financial statements. The regulators require the Company to meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Total capital, Tier 1 capital and Common equity tier 1 capital to risk-weighted assets (as defined in the regulations), and of Tier 1 capital to average assets (as defined in the regulations).

Beginning on January 1, 2016, a capital conservation buffer became effective for banking organizations, which is designed to establish a capital range above minimum requirements to insulate banks from periods of stress and impose constraints on dividends, share repurchases and discretionary bonus payments when capital levels fall below prescribed levels. The minimum capital conservation buffer in 2017 was 1.25%, 1.875% in 2018, and was fully phased in at 2.5% on January 1, 2019.

As of December 31, 2018, the Company and the Bank met all capital adequacy requirements to which they were subject, and the Bank's capital position exceeded the regulatory definition of well-capitalized.

At December 31, 2018 and 2017, the Company's and the Bank's actual and required capital ratios were as follows:

		2018					
		Actual		Minimum Required For Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Requirements	
(dollars in thousands)		Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>Total capital (to risk-weighted assets):</b>							
	Midland States Bancorp, Inc.	\$ 584,409	12.79 %	\$ 365,547	8.00 %	N/A	N/A
	Midland States Bank	583,465	12.76	365,894	8.00	\$ 457,368	10.00 %
<b>Tier 1 capital (to risk-weighted assets):</b>							
	Midland States Bancorp, Inc.	468,212	10.25	274,160	6.00	N/A	N/A
	Midland States Bank	561,402	12.27	274,421	6.00	365,894	8.00
<b>Common equity tier 1 capital (to risk-weighted assets):</b>							
	Midland States Bancorp, Inc.	400,480	8.76	205,620	4.50	N/A	N/A
	Midland States Bank	561,402	12.27	205,815	4.50	297,289	6.50
<b>Tier 1 leverage (to average assets):</b>							
	Midland States Bancorp, Inc.	468,212	8.53	219,602	4.00	N/A	N/A
	Midland States Bank	561,402	10.22	219,622	4.00	274,528	5.00
		2017					
		Actual		Minimum Required For Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Requirements	
(dollars in thousands)		Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>Total capital (to risk-weighted assets):</b>							
	Midland States Bancorp, Inc.	\$ 478,914	13.26 %	\$ 288,895	8.00 %	N/A	N/A
	Midland States Bank	445,285	12.32	289,252	8.00	\$ 361,565	10.00 %
<b>Tier 1 capital (to risk-weighted assets):</b>							
	Midland States Bancorp, Inc.	367,841	10.19	216,671	6.00	N/A	N/A
	Midland States Bank	428,184	11.84	216,939	6.00	289,252	8.00
<b>Common equity tier 1 capital (to risk-weighted assets):</b>							
	Midland States Bancorp, Inc.	304,974	8.45	162,503	4.50	N/A	N/A
	Midland States Bank	428,184	11.84	162,704	4.50	235,017	6.50
<b>Tier 1 leverage (to average assets):</b>							
	Midland States Bancorp, Inc.	367,841	8.63	170,566	4.00	N/A	N/A
	Midland States Bank	428,184	10.04	170,608	4.00	213,260	5.00

**Note 21 – Fair Value of Financial Instruments**

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting assumptions that a market participant would use when pricing an asset or liability. The hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows:

- Level 1: Unadjusted quoted prices for identical assets or liabilities traded in active markets.
- Level 2: Significant other observable inputs other than Level 1, including quoted prices for similar assets and liabilities in active markets, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

**Investment securities available for sale.** The fair values for investment securities available for sale are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For investment securities available for sale where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Securities classified as Level 3 are not actively traded, and as a result, fair value is determined utilizing third-party valuation services through consensus pricing. There were no transfers between Levels 1, 2 or 3 during the years ended December 31, 2018 or 2017 for assets measured at fair value on a recurring basis.

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

**Mortgage servicing rights held for sale.** The fair value of mortgage servicing rights held for sale is determined by quoted market prices less costs to sell (Level 1).

**Assets held for sale.** Assets held for sale represent the fair value of the banking facilities that are expected to be sold as a result of the branch network optimization plan that was announced in November 2016. The fair value of the assets held for sale was based on estimated market prices from independently prepared current appraisals. Such valuation inputs result in a fair value measurement that is categorized as a Level 2 measurement on a nonrecurring basis.

Assets and liabilities measured and recorded at fair value, including financial assets for which the Company has elected the fair value option, on a recurring and nonrecurring basis as of December 31, 2018 and 2017, are summarized below:

(dollars in thousands)	2018			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets and liabilities measured at fair value on a recurring basis:</b>				
<b>Assets</b>				
Investment securities available for sale:				
U.S. Treasury securities	\$ 24,650	\$ 24,650	\$ —	\$ —
Government sponsored entity debt securities	75,684	—	75,684	—
Agency mortgage-backed securities	326,305	—	326,305	—
State and municipal securities	159,262	—	159,262	—
Corporate securities	71,550	—	69,627	1,923
Equity securities	3,334	—	3,334	—
Loans held for sale	30,401	—	30,401	—
Interest rate lock commitments	4,492	—	4,492	—
Interest rate swap contracts	145	—	145	—
<b>Total</b>	<b>\$ 695,823</b>	<b>\$ 24,650</b>	<b>\$ 669,250</b>	<b>\$ 1,923</b>
<b>Liabilities</b>				
Interest rate swap contracts	\$ 145	\$ —	\$ 145	\$ —
<b>Assets measured at fair value on a non-recurring basis:</b>				
Mortgage servicing rights	\$ 53,447	\$ —	\$ —	\$ 53,447
Mortgage servicing rights held for sale	3,545	3,545	—	—
Impaired loans	11,238	—	9,226	2,012
Other real estate owned	1,439	—	1,439	—
Assets held for sale	1,687	—	1,687	—



	2017			
(dollars in thousands)	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets and liabilities measured at fair value on a recurring basis:				
<b>Assets</b>				
Investment securities available for sale:				
U.S. Treasury securities	\$ 27,718	\$ 27,718	\$ —	\$ —
Government sponsored entity debt securities	25,211	—	25,211	—
Agency mortgage-backed securities	232,387	—	232,387	—
State and municipal securities	102,567	—	102,567	—
Corporate securities	59,812	—	55,033	4,779
Equity Securities	2,830	—	2,830	—
Loans held for sale	50,089	—	50,089	—
Interest rate lock commitments	6,331	—	6,331	—
Forward commitments to sell mortgage-backed securities	31	—	31	—
Interest rate swap contracts	17	—	17	—
Total	<u>\$ 506,993</u>	<u>\$ 27,718</u>	<u>\$ 474,496</u>	<u>\$ 4,779</u>
<b>Liabilities</b>				
Interest rate swap contracts	17	—	\$ 17	\$ —
Assets measured at fair value on a non-recurring basis:				
Mortgage servicing rights	\$ 56,352	\$ —	\$ —	\$ 56,352
Mortgage servicing rights held for sale	10,176	10,176	—	—
Impaired loans	9,385	—	7,631	1,754
Other real estate owned	801	—	801	—
Assets held for sale	3,358	—	3,358	—

The following table presents losses recognized on assets measured on a non-recurring basis for the years ended December 31, 2018, 2017 and 2016:

(dollars in thousands)	2018	2017	2016
Mortgage servicing rights	\$ —	\$ 2,324	\$ 3,135
Mortgage servicing rights held for sale	458	4,059	—
Impaired loans	5,800	7,096	2,459
Other real estate owned	301	253	247
Assets held for sale	—	1,516	1,646
Total loss on assets measured on a nonrecurring basis	<u>\$ 6,559</u>	<u>\$ 15,248</u>	<u>\$ 7,487</u>

The following table presents activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2018 and 2017:

(dollars in thousands)	2018		2017	
	Corporate Securities	Corporate Securities	Corporate Securities	Non-Agency Mortgage-Backed Securities
Balance, beginning of period	\$ 4,779	\$ 7,480	\$ 1	1
Total realized in earnings <sup>(1)</sup>	242	289	—	—
Total unrealized in other comprehensive income	(36)	264	—	—
Net settlements (principal and interest)	(3,062)	(3,254)	(1)	(1)
Balance, end of period	\$ 1,923	\$ 4,779	\$ —	—

(1) Amounts included in interest income from investment securities taxable in the consolidated statements of income.

The following table presents quantitative information about significant unobservable inputs used in fair value measurements of non-recurring assets (Level 3) at December 31, 2018:

Non-recurring fair value measurements	Fair Value (dollars in thousands)	Valuation technique	Unobservable input / assumptions	Range (weighted average)
Mortgage servicing rights	\$ 53,447	Discounted cash flow	Prepayment speed Discount rate	8.00% - 18.00% (8.24%) 10.00% - 27.00% (11.12%)
Impaired loans	\$ 2,012	Fair value of collateral	Discount for type of property, age of appraisal and current status	5.00% - 7.26% (5.26%)

The following table presents quantitative information about significant unobservable inputs used in fair value measurements of non-recurring assets (Level 3) at December 31, 2017:

Non-recurring fair value measurements	Fair Value (dollars in thousands)	Valuation technique	Unobservable input / assumptions	Range (weighted average)
Mortgage servicing rights	\$ 56,352	Discounted cash flow	Prepayment speed Discount rate	6.36% - 42.90% (8.83%) 8.00% - 14.50% (11.18%)
Impaired loans	\$ 1,754	Fair value of collateral	Discount for type of property, age of appraisal and current status	4.84% - 18.24% (8.64%)

**Mortgage Servicing Rights.** In accordance with GAAP, the Company must record impairment charges on mortgage servicing rights on a non-recurring basis when the carrying value exceeds the estimated fair value. The fair value of our servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, replacement reserves and other economic factors which are estimated based on current market conditions. The determination of fair value of servicing rights relies upon Level 3 inputs. The fair value of mortgage servicing rights at December 31, 2018 and 2017 were \$53.4 million and \$56.4 million, respectively.

**Impaired loans.** Impaired loans are measured and recorded at fair value on a non-recurring basis. All of our nonaccrual loans and restructured loans are considered impaired and are reviewed individually for the amount of impairment, if any. Most of our loans are collateral dependent and, accordingly, we measure impaired loans based on the estimated fair value of such collateral. The fair value of each loan's collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the cost related to liquidating such collateral; such valuation inputs result in a nonrecurring fair value measurement that is categorized as a Level 2 measurement. When adjustments are made to an appraised value to reflect various factors such as the age of the appraisal or known changes in the market or the collateral, such valuation inputs are considered unobservable and the fair value measurement is categorized as a Level 3 measurement. The impaired loans categorized as Level 3 also include unsecured loans and other secured loans whose fair values are based significantly on unobservable inputs such as the strength of a guarantor, cash flows discounted at the effective loan rate, and management's judgment.

ASC Topic 825, *Financial Instruments*, requires disclosure of the estimated fair value of certain financial instruments and the methods and significant assumptions used to estimate such fair values. Additionally, certain financial instruments and all nonfinancial instruments are excluded from the applicable disclosure requirements.

The Company has elected the fair value option for newly originated residential and commercial loans held for sale. These loans are intended for sale and are hedged with derivative instruments. We have elected the fair value option to mitigate accounting mismatches in cases where hedge accounting is complex and to achieve operational simplification.

The following table presents the difference between the aggregate fair value and the aggregate remaining principal balance for loans for which the fair value option has been elected as of December 31, 2018 and 2017:

(dollars in thousands)	2018			2017		
	Aggregate fair value	Difference	Contractual principal	Aggregate fair value	Difference	Contractual principal
Residential loans held for sale	\$ 8,121	\$ 484	\$ 7,637	\$ 12,241	\$ 374	\$ 11,867
Commercial loans held for sale	22,280	595	21,685	37,846	343	37,503
Total loans held for sale	\$ 30,401	\$ 1,079	\$ 29,322	\$ 50,087	\$ 717	\$ 49,370

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets carried at fair value for the years ended December 31, 2018 and 2017:

(dollars in thousands)	2018	2017
Residential loans held for sale	\$ 6	\$ (74)
Commercial loans held for sale	252	(650)
Total loans held for sale	\$ 258	\$ (724)

The following tables are a summary of the carrying values and fair value estimates of certain financial instruments as of December 31, 2018 and 2017:

(dollars in thousands)	2018				
	Carrying Amount	Fair Value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets</b>					
Cash and due from banks	\$ 210,780	\$ 210,780	\$ 210,780	\$ —	\$ —
Federal funds sold	2,920	2,920	2,920	—	—
Investment securities available for sale	660,785	660,785	24,650	634,212	1,923
Nonmarketable equity securities	42,472	42,472	—	42,472	—
Loans, net	4,116,648	4,091,438	—	—	4,091,438
Loans held for sale	30,401	30,401	—	30,401	—
Accrued interest receivable	16,560	16,560	—	16,560	—
Interest rate lock commitments	4,492	4,492	—	4,492	—
Interest rate swap contracts	145	145	—	145	—
<b>Liabilities</b>					
Deposits	\$ 4,074,170	\$ 4,069,098	\$ —	\$ 4,069,098	\$ —
Short-term borrowings	124,235	124,235	—	124,235	—
FHLB and other borrowings	640,631	641,050	—	641,050	—
Subordinated debt	94,134	91,926	—	91,926	—
Trust preferred debentures	47,794	56,805	—	56,805	—
Accrued interest payable	4,855	4,855	—	4,855	—
Interest rate swap contracts	145	145	—	145	—

(dollars in thousands)	2017				
	Carrying Amount	Fair Value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets</b>					
Cash and due from banks	\$ 214,519	\$ 214,519	\$ 214,519	\$ —	\$ —
Federal funds sold	683	683	683	—	—
Investment securities available for sale	450,525	450,525	27,718	418,028	4,779
Nonmarketable equity securities	34,796	34,796	—	34,796	—
Loans, net	3,210,247	3,200,016	—	—	3,200,016
Loans held for sale	50,089	50,089	—	50,089	—
Accrued interest receivable	11,715	11,715	—	11,715	—
Interest rate lock commitments	6,331	6,331	—	6,331	—
Forward commitments to sell mortgage-backed securities	31	31	—	31	—
Interest rate swap contracts	17	17	—	17	—
<b>Liabilities</b>					
Deposits	\$ 3,131,089	\$ 3,127,626	\$ —	\$ 3,127,626	\$ —
Short-term borrowings	156,126	156,126	—	156,126	—
FHLB and other borrowings	496,436	494,634	—	494,634	—
Subordinated debt	93,972	90,860	—	90,860	—
Trust preferred debentures	45,379	46,069	—	46,069	—
Accrued interest payable	2,531	2,531	—	2,531	—
Interest rate swap contracts	17	17	—	17	—

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

## Note 22 – Commitments, Contingencies and Credit Risk

In the normal course of business, there are outstanding various contingent liabilities such as claims and legal actions, which are not reflected in the consolidated financial statements. No material losses are anticipated as a result of these actions or claims.

We are obligated under noncancelable operating leases for office space and other commitments. Certain leases contain escalation clauses providing for increased rental payments based primarily on increases in real estate taxes or in the average consumer price index. Net rent expense under operating leases included in occupancy and equipment expense was approximately \$3.2 million, \$2.7 million and \$2.4 million for the years ended December 31, 2018, 2017 and 2016, respectively.

The projected minimum rental payments under the terms of the leases as of December 31, 2018 are as follows:

(dollars in thousands)	Amount
Year ending December 31:	
2019	\$ 2,878
2020	2,361
2021	2,193
2022	1,955
2023	1,397
Thereafter	2,249
Total estimated lease payments	<u>\$ 13,033</u>

We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank used the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The commitments are principally tied to variable rates. Loan commitments as of December 31, 2018 and 2017 are as follows:

(dollars in thousands)	2018	2017
Commitments to extend credit	\$ 663,555	\$ 568,356
Financial guarantees – standby letters of credit	142,859	142,189

The Company establishes a mortgage repurchase liability to reflect management’s estimate of losses on loans for which the Company could have a repurchase obligation based on the volume of loans sold in 2018 and years prior, borrower default expectations, historical investor repurchase demand and appeals success rates, and estimated loss severity. Loans repurchased from investors are initially recorded at fair value, which becomes the Company’s new accounting basis. Any difference between the loan’s fair value and the outstanding principal amount is charged or credited to the mortgage repurchase liability, as appropriate. Subsequent to repurchase, such loans are carried in loans receivable. As a result of make-whole requests and loan repurchases, the Company incurred losses totaling \$11,000, \$17,000 and \$83,000 for the years ended December 31, 2018, 2017 and 2016, respectively. The liability for unresolved repurchase demands totaled \$492,000 and \$371,000 at December 31, 2018 and 2017, respectively.

## Note 23 – Segment Information

Our business segments are defined as Banking, Commercial FHA Origination and Servicing, Wealth Management and Other. The reportable business segments are consistent with the internal reporting and evaluation of the

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principle lines of business of the Company. The banking segment provides a wide range of financial products and services to consumers and businesses, including commercial, commercial real estate, mortgage and other consumer loan products; commercial equipment leasing; mortgage loan sales and servicing; letters of credit; various types of deposit products, including checking, savings and time deposit accounts; merchant services; and corporate treasury management services. The commercial FHA origination and servicing segment provides for the origination and servicing of government sponsored mortgages for multifamily and healthcare facilities. The wealth management segment consists of trust and fiduciary services, brokerage and retirement planning services. The other segment includes the operating results of the parent company, our captive insurance business unit, and the elimination of intercompany transactions.

During 2018, the Company re-evaluated its business segments and changed the composition of its reportable segments to those described above and restated all prior period information.

Selected business segment financial information as of and for the years ended December 31, 2018, 2017 and 2016 were as follows:

(dollars in thousands)	Banking	Commercial FHA Origination and Servicing	Wealth Management	Other	Total
<b>December 31, 2018</b>					
Net interest income (expense)	\$ 190,883	\$ (422)	\$ 298	\$ (10,672)	\$ 180,087
Provision for loan losses	9,430	—	—	—	9,430
Noninterest income	40,313	11,457	20,484	(463)	71,791
Noninterest expense	165,744	15,058	11,680	(839)	191,643
Income (loss) before income taxes (benefit)	56,022	(4,023)	9,102	(10,296)	50,805
Income taxes (benefit)	14,154	(979)	514	(2,305)	11,384
Net income (loss)	\$ 41,868	\$ (3,044)	\$ 8,588	\$ (7,991)	\$ 39,421
Total assets	\$ 5,571,752	\$ 91,108	\$ 18,218	\$ (43,405)	\$ 5,637,673
<b>December 31, 2017</b>					
Net interest income (expense)	\$ 135,974	\$ 312	\$ 524	\$ (7,148)	\$ 129,662
Provision for loan losses	9,556	—	—	—	9,556
Noninterest income	27,955	18,570	13,339	(502)	59,362
Noninterest expense	129,626	13,729	8,823	819	152,997
Income (loss) before income taxes (benefit)	24,747	5,153	5,040	(8,469)	26,471
Income taxes (benefit)	17,102	(1,033)	423	(6,077)	10,415
Net income (loss)	\$ 7,645	\$ 6,186	\$ 4,617	\$ (2,392)	\$ 16,056
Total assets	\$ 4,336,301	\$ 99,685	\$ 15,979	\$ (39,264)	\$ 4,412,701
<b>December 31, 2016</b>					
Net interest income (expense)	\$ 109,950	\$ 1,003	\$ —	\$ (5,699)	\$ 105,254
Provision for loan losses	5,591	—	—	—	5,591
Noninterest income	41,055	22,979	8,073	(50)	72,057
Noninterest expense	99,003	15,104	6,533	649	121,289
Income (loss) before income taxes (benefit)	46,411	8,878	1,540	(6,398)	50,431
Income taxes (benefit)	17,129	3,332	115	(1,687)	18,889
Net income (loss)	\$ 29,282	\$ 5,546	\$ 1,425	\$ (4,711)	\$ 31,542
Total assets	\$ 3,170,630	\$ 129,943	\$ 5,550	\$ (72,400)	\$ 3,233,723

### **Note 24 – Related Party Transactions**

The Company utilizes the services of a company to act as a general manager for the construction of new facilities. A member of our board of directors is a substantial shareholder of this company and currently serves as its Chairman. During the years ended December 31, 2018, 2017 and 2016, the Company paid \$418,000, \$20,000 and \$161,000, respectively, to this company for work on various projects.

A former member of our board of directors had an ownership interest in the Company's office building located in Clayton, Missouri and three of the Bank's full-service branch facilities as of December 31, 2018. During the years ended December 31, 2018, 2017 and 2016, the Company paid rent on these properties of \$712,000, \$719,000 and \$706,000, respectively.

A member of our board of directors has an ownership interest in a building the Company utilizes for office space located in Effingham, IL. During the year ended December 31, 2018, the Company paid rent on this space of \$42,000.

A member of our board of directors is an executive and board member of a company we utilize for relationship and marketplace studies. During the year ended December 31, 2017, the Company paid \$116,000 for these services.

#### **Note 25 – Revenue From Contracts with Customers**

On January 1, 2018, the Company adopted ASU No. 2014-09 “*Revenue from Contracts with Customers*” (Topic 606) and all subsequent ASUs that modified Topic 606. As stated in “*Note 2 – Basis of Presentation and Summary of Significant Accounting Policies*,” the implementation of the new standard did not have a material impact on the measurement or recognition of revenue. Since the impact of applying the standard was determined to be immaterial, the Company did not record a cumulative effect adjustment to beginning retained earnings on January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with previous GAAP.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and investment securities. In addition, certain noninterest income streams such as commercial FHA revenue, residential mortgage banking revenue and gain on sales of investment securities, net are also not in scope of the new guidance. Topic 606 is applicable to noninterest income streams such as wealth management revenue, service charges on deposit accounts, interchange revenue, gain on sales of other real estate owned, and certain other noninterest income streams. The recognition of revenue associated with these noninterest income streams did not change significantly from current practice upon adoption of Topic 606. The noninterest income streams considered in-scope by Topic 606 are discussed below.

**Wealth Management Revenue.** Wealth management revenue is primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company also earns investment advisory fees through its SEC registered investment advisory subsidiary. The Company’s performance obligation in both of these instances is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and contractually determined fee schedules. Payment is generally received a few days after month end through a direct charge to each customer’s account. The Company does not earn performance-based incentives. Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. The Company’s performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered. Fees generated from transactions executed by the Company’s third party broker dealer are remitted by them to the Company on a monthly basis for that month’s transactional activity.

**Service Charges on Deposit Accounts.** Service charges on deposit accounts consist of fees received under depository agreements with customers to provide access to deposited funds, serve as custodian of deposited funds, and when applicable, pay interest on deposits. These service charges primarily include non-sufficient fund fees and other account related service charges. Non-sufficient fund fees are earned when a depositor presents an item for payment in excess of available funds, and the Company, at its discretion, provides the necessary funds to complete the transaction. The Company generates other account related service charge revenue by providing depositors proper safeguard and remittance of funds as well as by delivering optional services for depositors, such as check imaging or treasury management, that are performed upon the depositor’s request. The Company’s performance obligation for the proper safeguard and remittance of funds, monthly account analysis and any other monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Payment for service charges on deposit accounts is typically received immediately or in the following month through a direct charge to a customer’s account.

**Interchange Revenue.** Interchange revenue includes debit / credit card income and ATM user fees. Card income is primarily comprised of interchange fees earned for standing ready to authorize and providing settlement on card transactions processed through the MasterCard interchange network. The levels and structure of interchange rates are set by MasterCard and can vary based on cardholder purchase volumes. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with completion of the Company’s performance obligation, the transaction processing services provided to the cardholder. Payment is typically received immediately or in the following month. ATM fees are primarily generated when a

Company cardholder withdraws funds from a non-Company ATM or a non-Company cardholder withdraws funds from a Company ATM. The Company satisfies its performance obligation for each transaction at the point in time when the ATM withdrawal is processed.

**Gain on Sales of Other Real Estate Owned.** The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to a buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain or loss on sale if a significant financing component is present.

**Other Noninterest Income.** The other noninterest income revenue streams within the scope of Topic 606 consist of merchant services revenue, safe deposit box rentals, wire transfer fees, paper statement fees, check printing commissions, and other noninterest related fees. Revenue from the Company's merchant services business consists principally of transaction and account management fees charged to merchants for the electronic processing of transactions. These fees are net of interchange fees paid to the credit card issuing bank, card company assessments, and revenue sharing amounts. Account management fees are considered earned at the time the merchant's transactions are processed or other services are performed. Fees related to the other components of other noninterest income within the scope of Topic 606 are largely transactional based, and therefore, the Company's performance obligation is satisfied and related revenue recognized, at the point in time the customer uses the selected service to execute a transaction.

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the years ended December 31, 2018, 2017 and 2016:

(dollars in thousands)	2018	2017	2016
<b>Noninterest income - in-scope of Topic 606</b>			
<i>Wealth management revenue:</i>			
Trust management/administration fees	\$ 16,099	\$ 9,751	\$ 5,985
Investment advisory fees	2,041	1,364	—
Investment brokerage fees	1,065	1,388	1,324
Other	1,308	837	782
<i>Service charges on deposit accounts:</i>			
Nonsufficient fund fees	7,672	4,193	2,562
Other	2,768	1,782	1,342
<i>Interchange revenues</i>	10,674	5,353	3,750
<i>Other income:</i>			
Merchant services revenue	1,650	1,103	1,697
Other	2,935	1,869	1,815
<b>Noninterest income - out-of-scope of Topic 606</b>	25,579	31,722	52,800
<b>Total noninterest income</b>	<b>\$ 71,791</b>	<b>\$ 59,362</b>	<b>\$ 72,057</b>

**Contract Balances.** A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2018 and 2017, the Company did not have any significant contract balances.

**Contract Acquisition Costs.** In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition costs.



**Note 26 – Parent Company Only Financial Information**

The following tables present condensed financial information for Midland States Bancorp, Inc.:

**Condensed Balance Sheets**  
(dollars in thousands)

	December 31,	
	2018	2017
<b>Assets:</b>		
Cash	\$ 20,312	\$ 60,424
Investment in common stock of subsidiaries	764,483	563,541
Accrued income taxes receivable	—	3,300
Other assets	2,330	2,303
Total assets	<u>\$ 787,125</u>	<u>\$ 629,568</u>
<b>Liabilities:</b>		
Subordinated debt	\$ 94,134	\$ 93,972
Trust preferred debentures	47,794	47,330
Other borrowings	33,021	37,294
Accrued income taxes payable	778	—
Deferred tax liabilities, net	972	252
Other liabilities	1,901	1,175
Total liabilities	<u>178,600</u>	<u>180,023</u>
Shareholders' equity	<u>608,525</u>	<u>449,545</u>
Total liabilities and shareholders' equity	<u>\$ 787,125</u>	<u>\$ 629,568</u>

**Condensed Statements of Income**  
(dollars in thousands)

	Years ended December 31,		
	2018	2017	2016
Dividends from subsidiaries	\$ 17,000	\$ 19,500	\$ —
Other income	6	4	428
Interest expense	(10,714)	(7,162)	(5,699)
Other expense	(1,180)	(1,295)	(1,130)
Income (loss) before income tax benefit and equity in undistributed income (loss) of subsidiaries	5,112	11,047	(6,401)
Income tax benefit	2,312	6,080	1,687
Income (loss) before equity in undistributed income (loss) of subsidiaries	<u>7,424</u>	<u>17,127</u>	<u>(4,714)</u>
Equity in undistributed income (loss) of subsidiaries	31,997	(1,071)	36,256
Net income	<u>\$ 39,421</u>	<u>\$ 16,056</u>	<u>\$ 31,542</u>

**Condensed Statements of Cash Flows**  
(dollars in thousands)

	Years ended December 31,		
	2018	2017	2016
<b>Cash flows from operating activities:</b>			
Net income	\$ 39,421	\$ 16,056	\$ 31,542
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Equity in undistributed (income) loss of subsidiaries	(31,997)	1,071	(36,256)
Amortization of restricted stock awards	1,199	836	555
Compensation expense for stock option grants	334	548	492
Change in other assets	3,273	(3,226)	4,237
Change in other liabilities	2,863	1,649	225
Net cash provided by operating activities	<u>15,093</u>	<u>16,934</u>	<u>795</u>
<b>Cash flows from investing activities:</b>			
Net cash paid in acquisition	(32,890)	(60,457)	—
Capital injection to subsidiaries	—	(350)	(25,250)
Net cash used in investing activities	<u>(32,890)</u>	<u>(60,807)</u>	<u>(25,250)</u>
<b>Cash flows from financing activities:</b>			
Payment made on subordinated debt	—	—	(8,000)
Proceeds from issuance of subordinated debt, net of issuance costs	—	39,354	—
Proceeds from other borrowings, net of issuance costs	—	39,964	—
Payments made on other borrowings	(4,286)	(2,857)	—
Cash dividends paid on preferred stock	(330)	(184)	(9,853)
Cash dividends paid on common stock	(19,977)	(14,008)	—
Proceeds from issuance of common stock in initial public offering, net of issuance costs	—	—	71,475
Proceeds from issuance of common stock under employee benefit plans	2,278	3,225	1,318
Net cash (used in) provided by financing activities	<u>(22,315)</u>	<u>65,494</u>	<u>54,940</u>
Net (decrease) increase in cash	<u>(40,112)</u>	<u>21,621</u>	<u>30,485</u>
<b>Cash:</b>			
Beginning of year	60,424	38,803	8,318
End of year	<u>\$ 20,312</u>	<u>\$ 60,424</u>	<u>\$ 38,803</u>

**Note 27 – Quarterly Condensed Financial Information (Unaudited)**

The following tables present the unaudited quarterly condensed financial information for the years ended December 31, 2018 and 2017:

(dollars in thousands, except per share data)	2018 Quarter Ended			
	March 31	June 30	September 30	December 31
Interest income	\$ 46,505	\$ 58,283	\$ 56,987	\$ 61,592
Interest expense	8,320	9,997	11,906	13,057
Net interest income	38,185	48,286	45,081	48,535
Provision for loan losses	2,006	1,854	2,103	3,467
Net interest income after provision for loan losses	36,179	46,432	42,978	45,068
Noninterest income	16,502	15,847	18,272	21,170
Noninterest expense	49,499	46,452	50,317	45,375
Income before income taxes	3,182	15,827	10,933	20,863
Income taxes	1,376	3,045	2,436	4,527
Net income	1,806	12,782	8,497	16,336
Preferred stock dividends	36	36	35	34
Net income available to common shareholders	\$ 1,770	\$ 12,746	\$ 8,462	\$ 16,302
Per common share data:				
Basic earnings per common share	\$ 0.08	\$ 0.53	\$ 0.35	\$ 0.68
Diluted earnings per common share	0.08	0.52	0.35	0.67

(dollars in thousands, except per share data)	2017 Quarter Ended			
	March 31	June 30	September 30	December 31
Interest income	\$ 31,839	\$ 34,528	\$ 43,246	\$ 43,500
Interest expense	4,378	5,128	6,481	7,464
Net interest income	27,461	29,400	36,765	36,036
Provision for loan losses	1,533	458	1,489	6,076
Net interest income after provision for loan losses	25,928	28,942	35,276	29,960
Noninterest income	16,342	13,619	15,403	13,998
Noninterest expense	30,797	37,645	48,363	36,192
Income before income taxes	11,473	4,916	2,316	7,766
Income taxes	2,983	1,377	280	5,775
Net income	\$ 8,490	\$ 3,539	\$ 2,036	\$ 1,991
Per common share data:				
Basic earnings per common share	\$ 0.54	\$ 0.21	\$ 0.10	\$ 0.10
Diluted earnings per common share	0.52	0.20	0.10	0.10

**Item 9 – Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A – Controls and Procedures**

Evaluation of disclosure controls and procedures. The Company’s management, including our President and Chief Executive Officer and our Chief Financial Officer, have evaluated the effectiveness of our “disclosure controls and procedures” (as defined in Rule 13a-15(e) under the Exchange Act), as of the end of the period covered by this report. Based on such evaluation, our President and Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of such period, the Company’s disclosure controls and procedures were effective as of that date to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company’s management, including its President and Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management’s annual report on internal control over financial reporting. Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting. Internal control is designed to provide reasonable assurance to the Company’s management and board of directors regarding the preparation of reliable published financial statements. Internal control over financial reporting includes self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Because of inherent limitations in any system of internal control, no matter how well designed, misstatements due to error or fraud may occur and not be detected, including the possibility of the circumvention or overriding of controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the Company’s internal control over financial reporting as of December 31, 2018. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management asserts that the Company maintained effective internal control over financial reporting as of December 31, 2018 based on the specified criteria.

The effectiveness of the Company’s internal control over financial reporting as of December 31, 2018, has been audited by Crowe LLP, the independent registered public accounting firm who also has audited the Company’s consolidated financial statements included in this Annual Report on Form 10-K.

Changes in internal control over financial reporting. There have not been any changes in the Company’s internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the fourth fiscal quarter of 2018 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

**Item 9B – Other Information**

None.

**Part III**

**Item 10 – Directors, Executive Officers and Corporate Governance**

This information can be found in the sections titled “Proposal 1 – Election of Directors,” “Section 16(a) Beneficial Ownership Reporting Compliance,” and “Corporate Governance and the Board of Directors” appearing in the Company’s Proxy Statement for the 2019 annual meeting of shareholders to be filed within 120 days after December 31, 2018, which is incorporated herein by reference.

**Item 11 – Executive Compensation**

This information can be found in the sections titled “Compensation Discussion and Analysis,” “Executive Compensation,” “Corporate Governance and the Board of Directors” and “Compensation Committee Report” appearing in the Company’s Proxy Statement for the 2019 annual meeting of shareholders to be filed within 120 days after December 31, 2018, which is incorporated herein by reference.

**Item 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Equity Compensation Plans. The following table discloses the number of outstanding options, warrants and rights granted to participants by the Company under our equity compensation plans, as well as the number of securities remaining available for future issuance under these plans as of December 31, 2018. The table provides this information separately for equity compensation plans that have and have not been approved by security holders. Additional information regarding stock incentive plans is presented in Note 17 to the Consolidated Financial Statements included pursuant to Item 8.

<b>Plan Category</b>	<b>(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>(b) Weighted-average exercise price of outstanding options, warrants and rights <sup>(1)</sup></b>	<b>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</b>
Equity compensation plans approved by shareholders <sup>(2)</sup>	895,923	\$ 18.21	27,859
Equity compensation plans not approved by shareholders	314,636	29.81	541,220
<b>Total</b>	<b>1,210,559</b>	<b>\$ 19.48</b>	<b>569,079</b>

- (1) The weighted average exercise price only relates to outstanding option awards.
- (2) Column (a) includes outstanding stock options granted from the Third Amendment and Restatement of Midland States Bancorp, Inc. 1999 Stock Option Plan, the Midland States Bancorp, Inc. Omnibus Stock Ownership and Long Term Incentive Plan, and the initial 1,000,000 shares reserved for issuance under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan. Column (c) reflects the remaining share reserve under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan attributable to the initial 1,000,000 shares reserved for issuance.
- (3) Column (a) includes 110,221 outstanding stock options granted from the additional 1,000,000 shares reserved for issuance under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan pursuant to the February 2, 2016 amendment and restatement and 204,415 stock units credited to participant accounts under the Deferred Compensation Plan for Directors of Midland States Bancorp, Inc. (Effective November 8, 2018) to be issued in accordance with the participant’s election following the participant’s separation from service or at a date certain from the additional 1,000,000 shares reserved for issuance under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan pursuant to the February 2, 2016 amendment and restatement. Column (c) reflects 440,612 shares remaining available for issuance under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan attributable to the additional 1,000,000 shares reserved for issuance pursuant to the February 2, 2016 amendment and restatement, and 100,608 shares remaining available for issuance under the Amended and Restated Midland States Bancorp, Inc. Employee Stock Purchase Plan.

Other information required by Item 12 can be found in the section titled “Security Ownership of Certain Beneficial Owners” appearing in the Company’s Proxy Statement for the 2019 annual meeting of shareholders to be filed within 120 days after December 31, 2018, which is incorporated herein by reference.

**Item 13 – Certain Relationships and Related Transactions, and Director Independence**

This information can be found in the sections titled “Certain Relationships and Related Party Transactions” and “Corporate Governance and the Board of Directors” appearing in the Company’s Proxy Statement for the 2019 annual meeting of shareholders to be filed within 120 days after December 31, 2018, which is incorporated herein by reference.

**Item 14 – Principal Accountant Fees and Services**

This information can be found in the section titled “Proposal 6 – Ratification of the Appointment of Crowe LLP as our Independent Registered Public Accounting Firm” appearing in the Company’s Proxy Statement for the 2019 annual meeting of shareholders to be filed within 120 days after December 31, 2018, which is incorporated herein by reference.

**Part IV**

**Item 15 – Exhibits and Financial Statement Schedules**

(a) The following documents are filed as part of this report:

(1) Financial Statements:

The following consolidated financial statements of the registrant and its subsidiaries are filed as part of this document under “Item 8. Financial Statements and Supplementary Data.”

Consolidated Balance Sheets – December 31, 2018 and 2017
Consolidated Statements of Income – Years Ended December 31, 2018, 2017 and 2016
Consolidated Statements of Comprehensive Income - Years Ended December 31, 2018, 2017 and 2016
Consolidated Statements of Shareholders’ Equity – Years Ended December 31, 2018, 2017 and 2016
Consolidated Statements of Cash Flows – Years Ended December 31, 2018, 2017 and 2016
Notes to Consolidated Financial Statements

(2) Financial Statement Schedules:

All schedules are omitted as such information is inapplicable or is included in the financial statements.

(3) Exhibits:

The exhibits are filed as part of this report and exhibits incorporated herein by reference to other documents are as follows:

Exhibit No.	Description
2.1	<a href="#"><u>Agreement and Plan of Merger, dated as of October 16, 2017, among Midland States Bancorp, Inc., Peak Midland Acquisition, LLC and Alpine Bancorporation, Inc. (incorporated by reference to Exhibit 2.1 to the Company’s Current Report on Form 8-K filed with the SEC on October 17, 2017).</u></a> †
2.2	<a href="#"><u>Agreement and Plan of Merger, dated as of January 26, 2017, among Midland States Bancorp, Inc., Sentinel Acquisition, LLC and Centrue Financial Corporation (incorporated by reference to Exhibit 2.1 to the Company’s Current Report on Form 8-K filed with the SEC on January 26, 2017).</u></a> †
2.3	<a href="#"><u>Agreement and Plan of Merger, dated April 7, 2014, among Midland States Bancorp, Inc., HB Acquisition LLC and Love Savings Holding Company (incorporated by reference to Exhibit 2.1 to the Company’s Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a> †
2.4	<a href="#"><u>Amendment to Agreement and Plan of Merger, dated November 6, 2014, among Midland States Bancorp, Inc., HB Acquisition LLC and Love Savings Holding Company (incorporated by reference to Exhibit 2.2 to the Company’s Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
3.1	<a href="#"><u>Articles of Incorporation of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Company’s Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
3.2	<a href="#"><u>Articles of Amendment to the Articles of Incorporation of Midland States Bancorp, Inc., effective May 8, 2018 (incorporated by reference to Exhibit 3.5 to the Company’s Quarterly Report on Form 10-Q filed with the SEC on August 8, 2018).</u></a>
3.3	<a href="#"><u>Statement of Resolution Establishing Series of Series G Preferred Stock of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K filed with the SEC on June 12, 2017).</u></a>

3.4	<a href="#"><u>Statement of Resolution Establishing Series of Fixed Rate Non-Voting Perpetual Non-Cumulative Preferred Stock, Series H of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on June 12, 2017).</u></a>
3.5	<a href="#"><u>By-laws of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
4.1	<a href="#"><u>Specimen common stock certificate of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.1	<a href="#"><u>Registration Rights Agreement, dated January 18, 2011, between Midland States Bancorp, Inc. and Richard E. Workman 2001 Trust (as amended by the Amendment Agreement, dated May 11, 2011, between Midland States Bancorp, Inc. and Richard E. Workman 2001 Trust, included as Exhibit 10.2, and by Amendment No. 2 to Registration Rights Agreement, dated December 10, 2013, between Midland States Bancorp, Inc. and Richard E. Workman 2001 Trust, included as Exhibit 10.3) (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.2	<a href="#"><u>Amendment Agreement, dated May 11, 2011, between Midland States Bancorp, Inc. and Richard E. Workman 2001 Trust (incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.3	<a href="#"><u>Amendment No. 2 to Registration Rights Agreement, dated December 10, 2013, between Midland States Bancorp, Inc. and Richard E. Workman 2001 Trust (incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.4*	<a href="#"><u>Transitional Employment Agreement, dated November 16, 2015, between Midland States Bancorp, Inc., Midland States Bank and Leon J. Holschbach (incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.5*	<a href="#"><u>Amendment No. 1 to Transitional Employment Agreement, dated as of December 15, 2017, between Midland States Bancorp, Inc., Midland States Bank and Leon J. Holschbach (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on December 19, 2017).</u></a>
10.6*	<a href="#"><u>Employment Agreement, dated as of December 1, 2010, between Midland States Bancorp, Inc., Midland States Bank and Jeffrey G. Ludwig (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.7*	<a href="#"><u>Amendment No. 1 to Employment Agreement, dated as of February 2, 2016, between Midland States Bancorp, Inc., Midland States Bank and Jeffrey G. Ludwig (incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.8*	<a href="#"><u>Amendment No. 2 to Employment Agreement, dated as of December 15, 2017, between Midland States Bancorp, Inc., Midland States Bank and Jeffrey G. Ludwig (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on December 19, 2017).</u></a>
10.9*	<a href="#"><u>Amendment No. 3 to Employment Agreement, dated as of January 1, 2019, between Midland States Bancorp, Inc., Midland States Bank and Jeffrey G. Ludwig – filed herewith.</u></a>
10.10*	<a href="#"><u>Employment Agreement, dated as of December 1, 2010, between Midland States Bancorp, Inc., Midland States Bank and Douglas J. Tucker (incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>



10.11*	<a href="#"><u>Amendment No. 1 to Employment Agreement, dated as of December 15, 2017, between Midland States Bancorp, Inc., Midland States Bank and Douglas J. Tucker (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on December 19, 2017).</u></a>
10.12*	<a href="#"><u>Amendment No. 2 to Employment Agreement, dated as of January 1, 2019, between Midland States Bancorp, Inc., Midland States Bank and Douglas J. Tucker – filed herewith.</u></a>
10.13*	<a href="#"><u>Midland States Bancorp, Inc. Omnibus Stock Ownership and Long Term Incentive Plan (incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.14*	<a href="#"><u>Third Amendment and Restatement of Midland States Bancorp, Inc. 1999 Stock Option Plan (incorporated by reference to Exhibit 10.9 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.15*	<a href="#"><u>Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.10 to Pre-Effective Amendment No. 2 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on May 11, 2016).</u></a>
10.16*	<a href="#"><u>Form of Incentive Stock Option Award Terms under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.17*	<a href="#"><u>Form of Non-Qualified Stock Option Award Terms under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.13 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.18*	<a href="#"><u>Form of Restricted Stock Unit Award Terms under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.14 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.19*	<a href="#"><u>Form of Restricted Stock Award Terms under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.15 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.20*	<a href="#"><u>Form of Restricted Stock Award Terms under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (for awards on and after November 6, 2018) (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on November 7, 2018).</u></a>
10.21*	<a href="#"><u>Deferred Compensation Plan for Directors of Midland States Bancorp, Inc. (Effective November 8, 2018) – filed herewith.</u></a>
10.22*	<a href="#"><u>Deferred Compensation Plan for Executives of Midland States Bancorp, Inc. (Effective November 8, 2018) – filed herewith.</u></a>
10.23*	<a href="#"><u>Midland States Bancorp, Inc. Management Incentive Program (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the SEC on November 13, 2017).</u></a>
10.24*	<a href="#"><u>Amended and Restated Midland States Bancorp, Inc. Employee Stock Purchase Plan (amended May 3, 2016), (incorporated by reference to Exhibit 10.17 to Pre-Effective Amendment No. 2 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on May 11, 2016).</u></a>

10.25	<a href="#"><u>Registration Rights Agreement, dated April 7, 2014, among Midland States Bancorp, Inc., Love Group, LLC, Love Real Estate Company, Bank of America and Andrew S. Love, Jr., as Trustees U/T/W of Andrew Sproule Love FBO Andrew Sproule Love, Jr., Love Investment Company, Andrew Sproule Love, Jr., as Trustee of The Love Family Charitable Trust, Andrew S. Love, Jr., Laurence A. Schiffer, James S. McDonnell III, and John F. McDonnell (incorporated by reference to Exhibit 10.18 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.26*	<a href="#"><u>Supplemental Retirement Benefit Agreement, effective November 16, 2015, by and between Midland States Bancorp, Inc. and Leon J. Holschbach (incorporated by reference to Exhibit 10.24 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u></a>
10.27*	<a href="#"><u>Employment Agreement, dated as of March 7, 2018, between Midland States Bancorp, Inc., Midland States Bank and Stephen A. Erickson (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K, filed with the SEC on March 7, 2018).</u></a>
10.28*	<a href="#"><u>Employment Agreement, dated as of December 20, 2012, between Midland States Bank and Jeffrey S. Mefford – filed herewith.</u></a>
10.29*	<a href="#"><u>Amendment No. 1 to Employment Agreement, dated as of December 15, 2017, between Midland States Bank and Jeffrey S. Mefford – filed herewith.</u></a>
10.30*	<a href="#"><u>Amendment No. 2 to Employment Agreement, dated as of January 1, 2019, between Midland States Bank and Jeffrey S. Mefford – filed herewith.</u></a>
10.32*	<a href="#"><u>Employment Agreement, dated as of February 20, 2017, between Midland States Bank and James R. Stewart – filed herewith.</u></a>
10.33*	<a href="#"><u>Amendment No. 1 to Employment Agreement, dated as of December 15, 2017, between Midland States Bank and James R. Stewart – filed herewith.</u></a>
21.1	<a href="#"><u>Subsidiaries of Midland States Bancorp, Inc. – filed herewith.</u></a>
23.1	<a href="#"><u>Consent of Crowe LLP – filed herewith.</u></a>
23.2	<a href="#"><u>Consent of KPMG LLP – filed herewith.</u></a>
31.1	<a href="#"><u>Chief Executive Officer's Certification required by Rule 13(a)-14(a) – filed herewith.</u></a>
31.2	<a href="#"><u>Chief Financial Officer's Certification required by Rule 13(a)-14(a) – filed herewith.</u></a>
32.1	<a href="#"><u>Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.</u></a>
32.2	<a href="#"><u>Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.</u></a>
101	Financial information from the Company's Annual Report on Form 10-K for the year ended December 31, 2018, formatted in XBRL interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to Consolidated Financial Statements – filed herewith.

\* Management contract or compensatory plan or arrangement

† Schedules and/or exhibits to this Exhibit have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish a copy of any omitted schedule or exhibit to the SEC upon request.

**Item 16 – Form 10-K Summary**

None.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**MIDLAND STATES BANCORP, INC.**

Date: February 27, 2019

By: /s/ Jeffrey G. Ludwig  
Jeffrey G. Ludwig  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signatures</u>	<u>Title</u>	<u>Date</u>
<u>/s/ John M. Schultz</u> John M. Schultz	Chairman of the Board of Directors	February 27, 2019
<u>/s/ Leon J. Holschbach</u> Leon J. Holschbach	Director, Vice Chairman	February 27, 2019
<u>/s/ Jeffrey G. Ludwig</u> Jeffrey G. Ludwig	President Chief Executive Officer (Principal Executive Officer)	February 27, 2019
<u>/s/ Stephen A. Erickson</u> Stephen A. Erickson	Chief Financial Officer (Principal Financial and Accounting Officer)	February 27, 2019
<u>/s/ Deborah A. Golden</u> Deborah A. Golden	Director	February 27, 2019
<u>/s/ Jerry L. McDaniel</u> Jerry L. McDaniel	Director	February 27, 2019
<u>/s/ Jeffrey M. McDonnell</u> Jeffrey M. McDonnell	Director	February 27, 2019
<u>/s/ Dwight A. Miller</u> Dwight A. Miller	Director	February 27, 2019
<u>/s/ Richard T. Ramos</u> Richard T. Ramos	Director	February 27, 2019
<u>/s/ Robert F. Schultz</u> Robert F. Schultz	Director	February 27, 2019
<u>/s/ R. Robert Funderburg, Jr.</u> R. Robert Funderburg, Jr.	Director	February 27, 2019
<u>/s/ Jennifer L. DiMotta</u> Jennifer L. DiMotta	Director	February 27, 2019
<u>/s/ Jeffrey C. Smith</u> Jeffrey C. Smith	Director	February 27, 2019

**AMENDMENT NO. 2 TO EMPLOYMENT AGREEMENT**

**THIS AMENDMENT NO. 2 TO EMPLOYMENT AGREEMENT** (this “**Amendment**”) is made and entered into as of January 1, 2019 (the “**Effective Date**”) by and between Midland States Bancorp, Inc. (the “**Company**”), Midland States Bank, an Illinois banking corporation (the “**Bank**”) (the Bank and the Company hereinafter collectively referred to as the “**Employer**”), and Douglas J. Tucker (“**Executive**”).

**RECITALS**

- A. The Executive serves as Senior Vice President, Corporate Counsel, of the Company and the Bank, and has entered into an Employment Agreement with the Company and the Bank, dated as of December 1, 2010, as amended by that certain Amendment No. 1 to Employment Agreement dated as of December 15, 2017 (the “**Employment Agreement**”).
- B. As a result of Amendment No. 1 to Executive’s Employment Agreement containing errors with respect to Executive’s bonus and long-term incentive award percentages, the Company’s Compensation Committee has instructed that an amendment to Executive’s Employment Agreement be executed reflecting the correct percentages.

**AGREEMENTS**

Now therefore, the Employment Agreement is hereby amended as follows:

**1.** The reference in Section 4(b) of the Employment Agreement to a target Incentive Bonus is hereby amended to “not less than forty percent (40%)”; and the reference to a long-term incentive bonus percentage for the Executive is hereby amended to “forty-five percent (45%).”

In all other respects the Employment Agreement shall remain fully in force and effect.

**IN WITNESS WHEREOF**, the parties have executed this Amendment as of the Effective Date.

**MIDLAND STATES BANCORP, INC. and  
MIDLAND STATES BANK**

**DOUGLAS J. TUCKER**

By: /s/ Leon J. Holschbach  
Name: Leon J. Holschbach  
Its: Vice-Chairman

/s/ Douglas J. Tucker  
[Signature]

**Deferred Compensation Plan for Directors  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

**Recitals**

The purpose of the Deferred Compensation Plan For Directors of Midland States Bancorp, Inc., effective November 8, 2018 (the “**Plan**”) is to enable Directors of Midland States Bancorp, Inc. (the “**Company**”), Midland States Bank, a wholly-owned subsidiary of the Company (the “**Bank**”), and members of their Controlled Group, to elect to defer all or a portion of the fees payable on account of service as a Director. The Plan is intended as a means of maximizing the effectiveness and flexibility of the compensation arrangements to Directors, and as an aid in attracting and retaining individuals of outstanding abilities and specialized skills for service. All obligations under the Plan will be solely borne by the Company, the Bank or the Controlled Group member for which the director performs services. It is the intent of the Company that the Plan complies in its entirety with the provisions of Code Section 409A and the Treasury Regulations and guidance promulgated thereunder.

The Plan was originally adopted by the Company as the Deferred Compensation Plan for Directors and Executive of Midland States Bancorp, Inc. on December 31, 2001 (the “**Original Plan**”) and was subsequently amended and restated from time to time. The Plan, as described herein, is effective as of November 8, 2018 (the “**Effective Date**”). As of the Effective Date, the Original Plan was split into two plans, one for Directors and the other for key executives of the Company, the Bank and members of their Controlled Group. The Plan, as described herein, is intended to amend and continue the Original Plan with respect to Directors.

**SECTION 1  
Definitions**

1.1 “**Account**” means any of the accounts or subaccounts established for each Participant pursuant to **Section 5.1**.

1.2 “**Beneficiary**” shall mean the person(s) Participant has designated in writing to the Committee to receive benefits under this Plan in the event of the Participant’s death. If the Participant has not specifically designated any Beneficiary for purposes of the Plan, then the Beneficiary shall be the Participant’s estate. In the case of the death of the Beneficiary before completion of payments under the Plan to the Beneficiary, then the Beneficiary’s estate shall become entitled to any remaining payments.

1.3 “**Board**” means the Board of Directors of the Company.

1.4 “**Change in Capital Stock**” shall mean any increase or decrease in the number of shares of issued Common Stock resulting from a subdivision or consolidation of shares, whether through reorganization, recapitalization, stock split-up, stock distribution or combination of shares, or the payment of a share dividend or other increase or decrease in the number of such shares outstanding effected without receipt of consideration by the Company.

1.5 “**Change of Control**” shall mean the first to occur of the following:

A. Any Person (as defined in Sections 13(d) and 14(d) of the Exchange Act), other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company or a corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the beneficial owner (within the meaning of Rule

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13d-3 of the Exchange Act), directly or indirectly, of securities representing fifty percent (50%) or more of the total voting power represented by the Company's then outstanding Voting Stock;

B. During any period of twelve (12) consecutive months, individuals who at the beginning of such period constitute the Board and any new director whose election by the Board or nomination for election by the Company's stockholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof; or

C. Consummation of: (i) a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the Voting Stock of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; or (ii) a complete liquidation of the Company or the Bank or an agreement for the sale or disposition by the Company of all or substantially all the Company's or the Bank's assets.

However, in no event shall a Change of Control be deemed to have occurred, with respect to the Participant if the Participant is part of a purchasing group which consummates the Change of Control transaction. The Participant shall be deemed "part of a purchasing group" for purposes of the preceding sentence if the Participant is an equity participant in the purchase company or group (except for (i) passive ownership of less than two percent (2%) of the stock of the purchasing company; or (ii) ownership of equity participation in the purchasing company or group which is otherwise not significant, as determined prior to the Change of Control by a majority of the continuing Directors).

In the event that any amount under the Plan constitutes deferred compensation (as defined under Code Section 409A), and the settlement of, or distribution of such amount is to be triggered by a Change of Control, then such settlement or distribution shall be subject to the event constituting the Change of Control also constituting a "change in the ownership" or "change in the effective control" of the Company, as permitted under Code Section 409A.

1.6 "**Code**" shall mean the Internal Revenue Code of 1986, as amended.

1.7 "**Committee**" shall mean the Compensation Committee of the Board or any other committee of the Board as may be designated from time to time by the Board, or any designee of either.

1.8 "**Common Stock**" shall mean the common stock of the Company.

1.9 "**Controlled Group**" shall mean any and all entities which share common ownership with the Company resulting in a "parent-subsidiary controlled group," as that term is defined by Code Section 1563(a)(1), or "brother-sister controlled group," as that term is defined by Code Section 1563(a)(2), or any "combined group," as that term is defined by Code Section 1563(a)(3).

1.10 "**Deferred Compensation**" shall mean Director Fees that are the subject of an elective deferral under **Section 4.1** of the Plan.

1.11 "**Deferred Compensation Account**" shall mean the bookkeeping account(s) established for a Participant under the Plan to which Deferred Compensation with respect to such Participant is credited from time to time, as provided in **Section 5.2** of the Plan.

1.12 "**Director**" shall mean any person duly elected or appointed and serving as a director of

the Company, the Bank or any other member of the Controlled Group and who is not a current employee of the Company, the Bank or any other member of the Controlled Group and has not been an employee of the Company, the Bank or any other member of the Controlled Group for at least one year.

1.13 “**Director Fees**” shall mean, with respect to any Plan Year, a Director’s retainer and other fees paid, in whatever form, for services rendered as a Director.

1.14 “**Disability**” shall mean with respect to a Participant, that the Participant: (A) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, or (B) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three months under an accident or health plan covering employees or directors of such Participant’s employer, as determined in accordance with Code Section 409A(a)(2)(C) and the Treasury Regulations thereunder.

1.15 “**Distributable Amount**” of a Participant’s accounts with respect to a Plan Year shall mean the sum of Deferred Compensation, Matching Contributions, and earnings, if any, thereon credited to a Participant’s Deferred Compensation Account and Matching Contribution Account, or any other accounts or subaccounts, with respect to such Plan Year.

1.16 “**Election Form**” shall mean the form (as set forth in EXHIBIT A hereto) which Participants use to defer Director Fees and to elect distribution options.

1.17 “**Election Period**” with respect to any Plan Year shall mean the period designated by the Committee; *provided, however*, that such period shall be no less than ten (10) business days. The Election Period with respect to a Plan Year shall end not later than the last day of the prior Plan Year; *provided, however*, that, in the case of a Participant who first becomes eligible to participate in the Plan during a Plan Year, the Election Period may be the thirty (30) day period commencing on the date such Participant first becomes eligible to participate in accordance with Code Section 409A(a)(4)(B)(ii) and the Treasury Regulations thereunder.

1.18 “**ERISA**” shall mean the Employee Retirement Income Security Act of 1974, as amended.

1.19 “**Exchange Act**” shall mean the Securities Exchange Act of 1934, as amended.

1.20 “**Fair Market Value**” means, on any date, the officially-quoted closing selling price of the shares on such date on the principal national securities exchange on which the shares are listed or admitted to trading (including the New York Stock Exchange, Nasdaq Stock Market, Inc. or such other market or exchange in which such prices are regularly quoted) or, if there have been no sales with respect to the shares on such date, or if the shares are not so listed or admitted to trading, the Fair Market Value shall be the value established by the Committee in good faith and in accordance with Code Sections 422 and 409A.

1.21 “**Matching Contribution Account**” shall mean the bookkeeping account established for a Participant under **Section 5.3** of the Plan to which the Company’s Matching Contributions under **Section 4.2** of the Plan are credited from time to time.

1.22 “**Participant**” shall mean a Director who has elected to participate in the Plan.

1.23 “**Payment Date**” shall mean, unless otherwise designated by the Participant on his or her Election Form, the last day of the calendar month following the date of the Participant’s Separation from



Service.

1.24 “**Plan Year**” shall mean the twelve (12) consecutive month period beginning on each January 1 and ending on each December 31.

1.25 “**Retirement**” shall mean the cessation of the services of a Director for any reason other than death or Disability, *provided* such Director is at least 70 years of age.

1.26 “**Separation from Service**” shall mean a “separation from service” within the meaning of Code Section 409A(a)(2)(A)(i).

1.27 “**Specified Employee**” shall have the meaning set forth in Code Section 409A(a)(2)(B)(i) and Treasury Regulation Section 1.409A-1(i).

1.28 “**Stock Units**” shall mean hypothetical units intended to track the number of shares of Common Stock (carried to four decimal places) credited to a Participant’s Deferred Compensation or Matching Contribution Account in accordance with the provisions of **Sections 5.2** and **5.3** of the Plan; *provided, however*, that in the event of a Change in Capital Stock, the Stock Units then credited to a Participant’s Deferred Compensation and Matching Contribution Accounts shall be appropriately adjusted, based on the Committee’s directions, to account for the change in number of issued and outstanding shares of Common Stock. No actual shares of Common Stock will be credited to any account under the Plan. Any Stock Units credited to a Participant’s Deferred Compensation or Matching Contribution Account shall, to the extent permitted by law, be issued under the Midland States Bancorp, Inc. Amended and Restated 2010 Long-Term Incentive Plan or any successor plan (each, a “**Company Equity Plan**”).

1.29 “**Treasury Regulations**” shall mean the regulations promulgated by the U.S. Department of Treasury under Chapter 26 of the U.S. Code of Federal Regulations or any successor thereto.

1.30 “**Unforeseeable Emergency**” shall mean a severe financial hardship to the Participant resulting from: (A) an illness or accident of the Participant, or the Participant’s spouse, Beneficiary, or dependent (as defined in Code Section 152, without regard to Code Sections 152(b)(1), (b)(2), and (d)(1)(B)); (B) loss of the Participant’s property due to casualty; or (C) other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the Participant’s control, as determined by the Committee, in its sole discretion, based on the relevant facts and circumstances and as provided for in Treasury Regulations §1.409A-3(i)(3) or any successor provision.

1.31 “**Voting Stock**” shall mean that class (or classes) of Common Stock entitled to vote in the election of the Company’s directors.

## **SECTION 2 Eligibility and Participation**

2.1 Eligibility. All Directors shall be eligible to participate in the Plan.

2.2 Participation. All Directors who elect to participate in the Plan shall be subject to the terms and conditions of the Plan and any properly completed, executed and filed Election Form(s). Upon becoming a Participant in the Plan, a Participant shall continue to participate in the Plan until such time as the Participant elects in accordance with the Plan to cease participation in the Plan or ceases to be a Director.

**SECTION 3**  
**Administration**

3.1 General Powers of Administration. The Plan shall be administered by the Committee. The Committee is authorized to construe and interpret the Plan and promulgate, amend and rescind rules and regulations relating to the implementation, administration and maintenance of the Plan. Subject to the terms and conditions of the Plan, the Committee, in its sole discretion, shall make all determinations necessary or advisable for the implementation, administration and maintenance of the Plan. The Committee may designate persons other than members of the Committee to carry out the day-to-day ministerial administration of the Plan under such conditions and limitations as it may prescribe. The Committee's determinations with respect to Directors must be uniform and may not be made selectively among Directors. Any determination, decision or action of the Committee in connection with the construction, interpretation, administration, implementation or maintenance of the Plan shall be final, conclusive and binding upon all Participants and any person(s) claiming any Plan benefits under or through any Participants.

3.2 Indemnification. The Company will indemnify and hold harmless the Committee, any Director or any employee charged with duties associated with the Plan against any cost or expense (including, without limitation, attorneys' fees) or liability (including, without limitation, any sum paid with the approval of the Company in settlement of a claim) arising out of any act or omission to act, except in the case of willful gross misconduct or gross negligence.

**SECTION 4**  
**Deferral and Matching Contributions**

4.1 Deferred Compensation. Participants may defer all or a portion of their Director Fees, earned during any Plan Year, in accordance with the following provisions.

A. *Deferral Election*. To defer Director Fees during any particular Plan Year, during the Election Period, Participants must complete, execute and file with the Committee an Election Form.

B. *Content of Deferral Elections*. The following shall apply to all deferral elections:

(i) All deferral elections shall contain a statement that the Participant elects to defer all or a portion of such Participant's Director Fees for a specified Plan Year that are earned and become payable to the Participant after the filing of such deferral election;

(ii) Any deferral election shall apply only to the Director Fees attributable to the Participant's services rendered to the Company during the Plan Year for which such election is made (whether or not such Director Fees are actually paid and received in such Plan Year), *provided that*, once a Participant has timely filed an Election Form in accordance with the Plan, such Election Form shall be effective for future Plan Years until modified or cancelled by the Participant in accordance with the Plan; and,

(iii) A Participant may cancel a deferral election for any Plan Year by filing with the Committee written notice of such cancellation prior to January 1 of the Plan Year for which such cancellation is to become effective, whereupon a Participant shall not be entitled to participate in the Plan for such Plan Year. Such a Participant may, however, participate with respect to future Plan Years by filing a new Election Form in accordance with the Plan.

4.2 Matching Contributions. If a Participant has elected to defer all (but not less than all) of his or

her Director Fees, on the first business day of each calendar quarter, or such other time as may be determined by the Committee in its sole discretion, the Company shall credit to the Participant's Matching Contribution Account, pursuant to **Section 5.3**, a contribution equal to 25% of such Participant's Director Fees deferred under the Plan during the preceding quarter (or other such period) (each such contribution, a "**Matching Contribution**"); *provided, however*, the matching contributions described herein shall apply only to Director Fees deferred with respect to any service period up to and including April 30, 2019. With respect to Director Fees deferred with respect to any service period on or after May 1, 2019, no matching contributions shall be available to any Director.

## **SECTION 5** **Plan Accounts**

5.1 Establishment of Plan Accounts. The Company shall establish on behalf of each Participant a Deferred Compensation Account and a Matching Contribution Account, and such other accounts and subaccounts as the Committee, in its sole discretion, shall determine from time to time. Without limiting the foregoing, a Participant's Deferred Compensation Account and Matching Contribution Account shall at all times be bookkeeping entries only and shall not represent any investment made on his or her behalf by the Company. The Participant shall at all times remain an unsecured creditor of the Company.

5.2 Credit to Deferred Compensation Account. A Deferred Compensation Account shall be created for each Participant, to which all Deferred Compensation shall be credited.

A. *Initial Credit to Deferred Compensation Account*. Each Participant's Deferred Compensation Account shall be credited no less frequently than the first business day of each calendar quarter with an amount equal to the sum of the cash Directors Fees deferred by the Participant during the preceding calendar quarter in accordance with **Section 4.1** of the Plan. The dollar amount of the cash Director Fees shall be credited as Stock Units, the number of which shall be calculated by dividing the dollar amount deferred by the Fair Market Value of the Common Stock as of the date such Deferred Compensation is credited to the Participant's Deferred Compensation Account; and, to the extent required pursuant to applicable law, the number of shares of Common Stock represented by the Stock Units shall be counted against the number of shares reserved for issuance under a Company Equity Plan.

B. *Earnings Credit to Account*. On the first business day of each calendar quarter, an amount equal to the sum of the cash dividends that would have been payable on all Stock Units then allocated to the Participant's Deferred Compensation Account had such Stock Units been actual shares of Common Stock during the immediately preceding calendar quarter, shall be credited to such Participant's Deferred Compensation Account, whereupon the dollar amount of such cash dividends shall be converted into Stock Units by dividing such dollar amount by the Fair Market Value of the Common Stock as of the first business day of such calendar quarter; and, to the extent required pursuant to applicable law, the number of shares of Common Stock represented by the Stock Units shall be counted against the number of shares reserved for issuance under a Company Equity Plan.

C. *Restricted Stock Units Credit to Account*. If a Participant has properly elected to defer the settlement of any restricted stock units ("**RSUs**") granted to such Participant pursuant to the terms of a Company Equity Plan, the number of such deferred RSUs shall be credited to an account or subaccount under the Participant's Deferred Compensation Account. The RSUs so deferred shall at all times remain subject to the terms of the Company Equity Plan pursuant to which they were issued; *provided, however*, that a properly elected deferral hereunder shall serve to defer the date of settlement of such RSUs until the date specified in a properly and timely completed, executed and

filed Election Form. RSUs deferred under the Plan shall not be entitled to any earnings thereon, except as may otherwise be provided pursuant to an applicable Company Equity Plan.

5.3 Matching Contribution Account. Each Participant's Matching Contribution Account shall be credited no less frequently than the first business day of each calendar quarter with an amount equal to any Matching Contributions made in accordance with **Section 4.2** of the Plan. The dollar amount of such Matching Contributions shall be converted into Stock Units by dividing such dollar amount by the Fair Market Value of the Common Stock as of the date such Matching Contributions are credited to the Participant's Matching Contribution Account. The Matching Contribution Account shall be credited with earnings in a manner similar to that described in **Section 5.2B** above.

**SECTION 6**  
**Vesting of Plan Accounts**

6.1 Vesting. Subject to **Section 10.12** below, a Participant's accounts shall vest in accordance with the following.

A. *Deferred Compensation Account*. A Participant's Deferred Compensation Account shall at all times be 100% vested; *provided, however*, with respect to any RSUs deferred hereunder, the vesting of such RSUs shall be determined in accordance with the Company Equity Plan pursuant to which such RSUs were granted.

B. *Matching Contribution Account*. The respective portion of a Participant's Matching Contribution Account credited in any Plan Year during the Participant's first four years of service to the Company shall vest in accordance with the following schedule:

<u>Full Years of Service</u>	<u>Vested Percentage</u>
1	25%
2	50%
3	75%
4	100%

All amounts credited to a Participant's Matching Contribution Account on or following the fourth anniversary of the Participant's start date shall at all times be vested in full. Notwithstanding the above vesting schedule, a Participant's Matching Contribution Account shall become 100% vested upon: (i) the death or Disability of the Participant; (ii) a Change of Control of the Company; or (iii) the Participant's Retirement.

C. *Other Accounts and Subaccounts*. Any other accounts or subaccounts established by the Committee from time to time shall vest in accordance with the terms and conditions established by the Committee.

**SECTION 7**  
**Payment to Participants**

7.1 General Rule. Unless otherwise determined by the Committee in its sole discretion, each Participant shall make a separate distribution election with respect to each Plan Year for which such Participant elects to defer Director Fees. A Participant's Election Form with respect to a Plan Year shall specify the Payment Date and the form of distribution of his or her Distributable Amount with respect to such Plan Year. Any distribution to a Participant pursuant to the Plan shall be made or commence on such Participant's Payment Date.

The limitations under this subsection shall be applied in accordance with Code Section 409A(a)(4)(C) and the Treasury Regulations thereunder.

A. *Normal Form*. Subject to **Section 10.16**, and except as provided in **paragraph B** below, a Participant's Distributable Amount of cash Director Fees (including any Matching Contributions with respect thereto) with respect to each Plan Year shall be paid to the Participant in a single distribution of Common Stock under the applicable Company Equity Plan, on the Participant's Payment Date, and a Participant's Distributable Amount of RSUs shall be paid to the Participant in Common Stock unless otherwise provided in the applicable Company Equity Plan. Notwithstanding anything herein to the contrary, the Committee may, in its sole discretion, elect to distribute any Participant's Distributable Amount of cash Director Fees (including any Matching Contributions with respect thereto) in cash.

B. *Optional Forms*. Instead of receiving his or her Distributable Amount with respect to each Plan Year in the form of a single lump sum, the Participant may elect an optional form of payment (on the Election Form) at the time of the Participant's deferral election for such Plan Year. The Participant may elect to receive the Distributable Amount in equal monthly installments over a period of two (2) to fifteen (15) years beginning on the Participant's Payment Date. The payment of such Participant's Distributable Amount with respect to each Plan Year shall be made or commence on such Participant's Payment Date.

All installment payments made under the Plan shall be determined in accordance with the annual fractional payment method, calculated as follows: the balance of the Participant's accounts with respect to a Plan Year shall be calculated as of the date of distribution. The annual installment shall be calculated by multiplying this balance by a fraction, the numerator of which is one, and the denominator of which is the remaining number of annual payments due to the Participant. By way of example, if the Participant elects 10 annual installments for the distribution of his or her accounts with respect to a Plan Year, the first payment shall be 1/10 of the balance of such accounts calculated as described in this paragraph. The following year, the payment shall be 1/9 of the balance of the Participant's accounts, calculated as described in this paragraph. The final distribution shall be based on 100% of the balance of the Participant's accounts as of the date of distribution.

The amount of each monthly installment shall then be determined by further dividing the annual installment with respect to any particular year by 12 to arrive at the amount of each monthly installment. Each monthly installment shall be paid on the last business day of the applicable month. The Committee may, in its sole discretion, adjust an elected distribution schedule in an effort to avoid any potential violation of Code Section 409A.

7.2 Death Before Payment of Benefits. If a Participant dies before the balance of the Participant's accounts have been paid to the Participant, any remaining payments will be made to the Participant's Beneficiary in the same form and manner as they would have been made to the Participant under the provisions of **Section 7.1** above.

7.3 Distributions in Cases of Hardship. Notwithstanding the provisions of **Section 7.1** above, the

Committee may, in its sole discretion, choose to permit a Participant to withdraw amounts from his or her vested accounts upon a showing by such Participant that an Unforeseeable Emergency has occurred. Such distribution shall be limited to the amount shown to be necessary to meet the Unforeseeable Emergency, and no more than one withdrawal will be permitted from a Participant's accounts during any Plan Year.

Any amounts distributed to a Participant pursuant to an Unforeseeable Emergency shall be considered to be taxable compensation to the Participant in the Plan Year of withdrawal.

7.4 Prohibition on Acceleration of Distributions. Subject to **Section 7.5** below, the time or schedule of payment of any withdrawal or distribution under the Plan shall not be subject to acceleration, except as provided under Treasury Regulations promulgated in accordance with Code Section 409A.

7.5 Re-deferrals and Changing the Form of Payment. In accordance with procedures established from time-to-time by the Committee in its sole discretion, the Participant may make an election to re-defer all or a portion of the amounts in his or her Deferred Compensation Account and Matching Contribution Account until a later distribution date or to change the form of a payment (a "**Re-deferral Election**"); *provided that*, the following requirements are met:

A. The Re-deferral Election is made at least twelve (12) months before the original distribution date;

B. The distribution date for the re-deferred amounts is at least five (5) years later than the original distribution date; and

C. The Re-deferral Election will not take effect for at least twelve (12) months after the Re-deferral Election is made.

7.6 Limited Cashouts. Notwithstanding any provision of the Plan or any Participant election to the contrary, the Committee may accelerate payment of a Participant's account(s) to the extent that (i) the aggregate amount of the Participant's account(s) does not exceed the applicable dollar amount under Code Section 402(g)(1)(B), (ii) the payment results in the termination of the Participant's entire interest in the Plan and any plans that are aggregated with the Plan pursuant to Treas. Reg. Section 1.409A-1(c)(2), and (iii) the Committee's decision to cash out the Participant's account(s) is evidenced in writing no later than the date of payment.

7.7 Specified Employee. Notwithstanding anything in the Plan to the contrary, if a Participant is a Specified Employee as of the date of his or her Separation from Service, then no distribution of such Participant's Account shall be made upon the Participant's Separation from Service until the first payroll date of the seventh month following the Participant's Separation from Service (or, if earlier, upon the date of the Participant's death) (the "**Specified Employee Payment Date**"). Any payments to which a Specified Employee otherwise would have been entitled under the Plan during the period between the Participant's Separation from Service and the Specified Employee Payment date shall be accumulated and paid in a lump sum payment on the Specified Employee Payment Date.

## **SECTION 8**

### **Participant Statements**

8.1 Annual Participant Statements. Within a reasonable period of time following the end of each Plan Year, each Participant shall be provided with a statement showing the balances (vested and nonvested) in the Participant's Deferred Compensation and Matching Contribution Accounts.

8.2 Termination of Participant's Employment or Service. Within 30 days following the date of the Participant's termination of employment or service (for any reason), the Participant shall be provided with a statement showing the vested balances of his or her Deferred Compensation and Matching Contribution Accounts as of the date of such termination.

## **SECTION 9 Amendment or Termination of Plan**

Any amendment to this Plan shall be made pursuant to a duly adopted resolution of the Board; *provided, however*, that if such amendment directly or indirectly affects the benefits payable under the Plan, such amendment must be mutually agreed to in writing by a Participant (or, in the event that such Participant is deceased at the date of amendment, the Beneficiary). Notwithstanding the foregoing, at the time of a Change of Control, the Board may unilaterally terminate and distribute all Accounts in accordance with Code Section 409A.

## **SECTION 10 General Provisions**

10.1 Participant's Rights Unfunded. The Plan at all times shall be unfunded as defined under provisions of the Code. The right of any Participant or Beneficiary to receive a distribution hereunder shall be an uninsured claim against the general assets of the Company in the event of the Company's insolvency or bankruptcy. The Company may implement a form of trust arrangement (known generally as a "rabbi trust") to hold the Company assets which will be used to make payments to the Participant (or any Beneficiary) under the terms of the Plan. Such trust arrangement will not be a "funded" arrangement under the provisions of the Code.

10.2 Independence of Other Benefit Arrangements. Participation in the Plan shall in no way restrict or otherwise impact Participant's participation in any other welfare benefit plan, employment or other contract, deferred compensation arrangement, equity participation plan or any other form of retirement benefit arrangement sponsored by the Company.

10.3 No Secured Guarantee of Benefits. In the event of the insolvency or bankruptcy of the Company, Participant shall remain a general creditor of the Company with respect to any benefits payable under the Plan, and nothing contained in the Plan shall constitute a secured guaranty by the Company or any other person or entity that the assets of the Company will be sufficient to pay any benefit hereunder in the event of the Company's insolvency or bankruptcy.

10.4 No Enlargement of Rights. No Participant shall have any right to receive a distribution of any benefits under the Plan except in accordance with the terms of the Plan. Establishment of the Plan shall not be construed to give any Participant the right to be retained in the service of the Company or any other member of the Controlled Group, whether as an employee, officer or director.

10.5 Spendthrift Provision. No interest of any person or entity in, or right to receive a distribution under the Plan shall be subject in any manner to sale, transfer, assignment, pledge, attachment, garnishment or other alienation or encumbrance of any kind; nor may such interest or right to receive a distribution be taken, either voluntarily or involuntarily, for the satisfaction of the debts of, or other obligations or claims against, such person or entity, including claims for alimony, support, separate maintenance and claims in bankruptcy proceedings.

10.6 Applicable Law. The Plan shall be construed and administered under the laws of the State of Illinois.

10.7 Severability. In the event that any of the provisions of the Plan are held to be inoperative or invalid by any court of competent jurisdiction, then: (i) insofar as is reasonable, effect will be given to the intent manifested in the provision held invalid or inoperative; and (ii) the validity and enforceability of the remaining provisions of the Plan will not be affected thereby.

10.8 Incapacity of Recipient. If any person entitled to a distribution under the Plan is deemed by the Committee to be incapable (physically or mentally) of personally receiving and giving a valid receipt for any payment pursuant to the Plan, then, unless and until claim therefore shall have been made by a duly appointed guardian or other legal representative of such person, the Company may provide for such payment or any part thereof to be made to any other person or institution then contributing towards or providing for the care and maintenance of such person. Any such payment shall be a payment for the account of such person and a complete discharge of any liability of the Company and the Plan with respect to such payment.

10.9 Successors. The terms and conditions of the Plan will be binding on the Company's and Participant's successors, heirs and assigns.

10.10 Unclaimed Benefits. Participant shall keep the Company informed of his or her current address and the current address of his or her Beneficiary. The Company shall not be obligated to search for the whereabouts of any person. If the location of any Participant is not made known to the Company within a one (1) year period after the date on which payment is to be made under the provisions of **Section 7.1**, then payment may be made by the Company to the Beneficiary instead. If, within one (1) additional year after such initial one (1) year period, the Company is unable to locate any designated Beneficiary of the Participant, then the Company shall use its reasonable best efforts to distribute all unclaimed benefits to the estate or other representative of the Participant.

10.11 Limitations on Liability. Participant and any other person claiming benefits under the Plan shall be entitled under this Plan only to those payments provided in accordance with the provisions of the Plan ("**Payment Claims**"). With the exception of the provisions of **Section 10.13** of the Plan, neither the Company, the Company Successor nor any individual acting as an employee or agent of the Company or the Company Successor, shall be liable to Participant or any other person for any other claim, loss, liability or expense under this Plan not directly related to a Payment Claim.

10.12 Forfeiture of Benefits. Notwithstanding any other provision of the Plan, should Participant engage in theft, fraud or embezzlement causing significant property damage to the Company, then any benefits payable to such Participant under the Plan will automatically be forfeited. The determination of theft or embezzlement will be made by the Board in good faith, but such determination does not require an actual criminal indictment or conviction prior to or after such decision. In any determination of forfeiture pursuant to this **Section 10.12**, the Participant will be given the opportunity to refute any such decision by the Board, but the Board's decision on the matter will be considered final and binding on Participant and all other parties.

10.13 Payment of Attorneys' Fees, Court Costs, and Interest on Loss of Benefits. Should either the Company or the Company Successor or a Participant bring an action at law (or through arbitration) in order that the Plan's terms be enforced, then the party prevailing in the action at law (or through arbitration) shall be entitled to reimbursement from the losing party for reasonable attorneys' fees, court costs and other similar amounts expended in the enforcement of the terms of the Plan. In addition, should the prevailing party be the Participant, he or she shall also be entitled to interest on any delayed payments, with such interest computed in accordance with **Section 5.2** above.

10.14 Withholding. There shall be deducted from all payments under the Plan the amount of any



taxes required to be withheld by any federal, state or local government. The Participants, any Beneficiaries and personal representatives shall bear any and all federal, foreign, state, and local, income or other taxes imposed on amounts paid under the Plan.

10.15 Participants Bound By Terms of the Plan. Each Participant shall be deemed conclusively to have accepted and consented to all terms of the Plan and all actions or decisions made by the Company with regard to the Plan. Such terms and consent shall also apply to and be binding upon any Beneficiaries, personal representatives and successors of each Participant. Each Participant shall receive a copy of the Plan.

10.16 No Distribution of Fractional Shares. Notwithstanding the credit of fractional interest in Stock Units in a Participant's Deferred Compensation Account or Matching Contribution Account, no fractional shares or interests shall be distributed to a Participant. Rather, such Participant shall be entitled to receive cash for such fractional shares or interest in an amount equal to the value thereof, determined with reference to the then per share Fair Market Value of the Common Stock.

10.17 Code Section 409A. The Company intends that the Plan comply with the requirements of Code Section 409A and shall be operated and interpreted consistent with that intent. Notwithstanding the foregoing, the Company makes no representation that the Plan complies with Code Section 409A and shall have no liability to any Participant for any failure to comply with Code Section 409A. The Plan shall constitute an "account balance plan" as defined in Treasury Regulation Section 31.3121(v)(2)-1(c)(1)(ii)(A). For purposes of Code Section 409A, all amounts deferred under this Plan shall be aggregated with amounts deferred under other account balance plans.

## **SECTION 11 Claims Procedures**

11.1 Presentation of Claim. Any Participant or Beneficiary of a deceased Participant (such Participant or Beneficiary being referred to below as a "**Claimant**") may deliver to the Committee a written claim for a determination with respect to the amounts distributable to such Claimant from the Plan. If such a claim relates to the contents of a notice received by the Claimant, the claim must be made within sixty (60) days after such notice was received by the Claimant. All other claims must be made within one hundred-eighty (180) days of the date on which the event that caused the claim to arise occurred. The claim must state with particularity the determination desired by the Claimant.

11.2 Notification of Decision. The Committee shall consider a Claimant's claim within a reasonable time, but no later than ninety (90) days; *provided* that claims based on Disability shall be considered within forty-five (45) days, unless, within such time, the Committee notifies the Claimant in writing that an extension is required pursuant to Labor Regulation 2560.503-1 (up to ninety (90) days for non-Disability claims and thirty (30) days for Disability claims). Once a decision is made, the Committee shall notify the Claimant in writing:

A. That the Claimant's requested determination has been made, and that the claim has been allowed in full; or

B. That the Committee has reached a conclusion contrary, in whole or in part, to the Claimant's requested determination, and such notice must set forth in a manner calculated to be understood by the Claimant:

- (i) the specific reason(s) for the denial of the claim, or any part of it;

(ii) the specific reference(s) to pertinent provisions of the Plan upon which such denial was based;

(iii) a description of any additional material or information necessary for the Claimant to perfect the claim, and an explanation of why such material or information is necessary; and

(iv) an explanation of the claim review procedure set forth in **Section 11.3** below, including the Claimant's right to bring a civil action under ERISA Section 502(a) as described in **Section 11.5** below.

11.3 Review of a Denied Claim. Within sixty (60) days (one hundred-eighty (180) days for a claim based on Disability) after receiving a notice from the Committee that a claim has been denied, in whole or in part, a Claimant (or the Claimant's duly authorized representative) may file with the Committee a written request for a review of the denial of the claim. Thereafter, but not later than thirty (30) days after the review procedure began, the Claimant (or the Claimant's duly authorized representative):

- A. may review pertinent documents;
- B. may submit written comments or other documents; and/or
- C. may request a hearing, which the Committee, in its sole discretion, may grant.

11.4 Decision on Review. The Committee shall render its decision on review promptly, and not later than sixty (60) days (forty-five (45) days for a claim based on Disability) after the filing of a written request for review of the denial, unless a hearing is held or other special circumstances require additional time, in which case the Committee's decision must be rendered within one hundred-twenty (120) days after such date; *provided* that this period shall include up to one (1) forty-five (45)-day extension for claims based on Disability. Such decision must be written in a manner calculated to be understood by the Claimant, and it must contain:

- A. specific reasons for the decision;
  - B. specific reference(s) to the pertinent Plan provisions upon which the decision was based;
- and
- C. such other matters as the Committee deems relevant.

11.5 Legal Action. A Claimant's compliance with the foregoing provisions of this **Section 11** is a mandatory prerequisite to a Claimant's right to commence any legal action with respect to any claim for benefits under this Plan.

EXHIBIT A

**Deferred Compensation Plan for Directors  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

DEFERRED COMPENSATION ELECTION FORM

Pursuant to the Deferred Compensation Plan For Directors of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby elect the following actions in conjunction with my service as a Director. Unless the context clearly requires otherwise, capitalized terms herein shall have the same meanings as ascribed to them under the Plan.

- To defer cash Director Fees otherwise payable to me for the 20\_\_\_\_ Plan Year in the aggregate amount of  all or  \$\_\_\_\_\_.
- All of the amount deferred shall be allocated to my Deferred Compensation Account.
- To defer RSU Director Fees otherwise payable to me for the 20\_\_\_\_ Plan Year in the aggregate amount of  all or  \_\_\_\_\_ (number of RSUs being deferred).
- All of the amount deferred shall be allocated to my Deferred Compensation Account.
- Timing of Distributions (Participant Payment Date) (***select one***):
  - Date Certain Election: For all deferrals for the 20\_\_\_\_ Plan Year, I elect payment on the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year), or
  - Separation from Service: For all deferrals for the 20\_\_\_\_ Plan Year, I elect payment only upon a Separation from Service, or
  - I elect payment on earlier of the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year) or upon a Separation from Service.
- Method of Distribution (***select one***):
  - Monthly Installments over \_\_\_\_\_ years (minimum of 2, maximum of 15).
  - Lump-sum.

The elections specified above (if any) will continue in effect for future years until revoked.

Date:

Signature

Print Name

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**Deferred Compensation Plan for Directors  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

BENEFICIARY DESIGNATION FORM

Pursuant to the Deferred Compensation Plan For Directors of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby designate the following persons as my beneficiaries to receive all amounts held for me under the Plan which have not been paid to me at the date of my death:

Primary Beneficiary(ies):

Name:

Name:

Relationship:

Relationship:

Percentage:

Percentage:

Secondary Beneficiary(ies)

Name:

Name:

Relationship:

Relationship:

Percentage:

Percentage:

The designation of beneficiaries specified above (if any) will continue in effect for future years until revoked.

Date:

Signature

Print Name

**Deferred Compensation Plan for Directors  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

REQUEST FOR HARDSHIP WITHDRAWAL

Pursuant to the Deferred Compensation Plan For Directors of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby request a hardship withdrawal from the balance in my Deferred Compensation Account relative to the \_\_\_\_\_ Plan Year in the amount of \$\_\_\_\_\_ as a result of the occurrence of an Unforeseeable Emergency, as more particularly described on the page attached hereto.

Date:

Signature

Print Name

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**Deferred Compensation Plan for Directors  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

RE-DEFERRAL ELECTION FORM

Pursuant to the Deferred Compensation Plan For Directors of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby elect the following actions with respect to amounts that I have previously deferred under the Plan. Unless the context clearly requires otherwise, capitalized terms herein shall have the same meanings as ascribed to them under the Plan.

**Previous Deferral Election:**

- This Re-Deferral Election is made with respect to (***select only one***):
  - Director Fees otherwise payable to me for the 20\_\_\_\_ Plan Year
- With respect to the Director Fees identified above, I originally elected to receive such deferrals:
  - In the form of (***select only one***):
    - monthly installments over \_\_\_\_\_ years, or
    - a lump sum
  - With such payment originally scheduled to commence (***select only one***):
    - Date Certain Election: On the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year), or
    - Upon a Separation from Service, or
    - Upon the earlier of the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year) or a Separation from Service.

**Re-Deferral Election:**

- In the form of (***select only one***):
  - monthly installments over \_\_\_\_\_ years, or
  - a lump sum
- With such payment re-deferred until (***select only one***):
  - Date Certain Election (must be at least five (5) years later than originally elected Date Certain Election identified above): On the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year), or
  - Five (5) years after my Separation from Service, or
  - Upon the earlier of the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year) (any new specified date must be at least five (5) years later than the originally elected date) or a Separation from Service, or
  - (*Available only in limited circumstances*) Upon the later of five years following a Separation from Service or the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year)

[Signature page follows]

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By signing below, I acknowledge that: (i) this Re-Deferral Election Form is being executed by me at least twelve (12) months prior to the time I would otherwise be entitled to receive the Director Fees identified above; (ii) this Re-Deferral Election Form will not take effect until the date that is twelve (12) months after this Re-Deferral Election Form has been executed and presented to the Plan administrator; and (iii) if I have incorrectly completed this Re-Deferral Form, the Plan administrator has no obligation to accept it as an effective Re-Deferral Election. I further acknowledge and agree that this Re-Deferral Election will not be effective until acknowledged and accepted by Human Resources at Midland States Bancorp, Inc.

You must attach a copy of your originally submitted Deferred Compensation Election Form to this Re-Deferral Election Form.

Date:

Signature

Print Name

Acknowledged and accepted by Human Resources at Midland States Bancorp, Inc.

Date:

Signature

Print Name

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**Deferred Compensation Plan for Executives  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

**Recitals**

The purpose of the Deferred Compensation Plan For Executives of Midland States Bancorp, Inc., effective November 8, 2018 (the “**Plan**”) is to enable selected key Executives of Midland States Bancorp, Inc. (the “**Company**”), Midland States Bank, a wholly-owned subsidiary of the Company (the “**Bank**”), and members of their Controlled Group, to elect to defer all or a portion of the cash compensation payable on account of service as a key Executive. The Plan is intended as a means of maximizing the effectiveness and flexibility of the compensation arrangements to selected key Executives, and as an aid in attracting and retaining individuals of outstanding abilities and specialized skills for service. All obligations under the Plan will be solely borne by the Company, the Bank or the Controlled Group member that employs the key Executive. It is the intent of the Company that the Plan complies in its entirety with the provisions of Code Section 409A and the Treasury Regulations and guidance promulgated thereunder.

The Plan was originally adopted by the Company as the Deferred Compensation Plan for Directors and Executive of Midland States Bancorp, Inc. on December 31, 2001 (the “**Original Plan**”) and was subsequently amended and restated from time to time. The Plan, as described herein, is effective as of November 8, 2018 (the “**Effective Date**”). As of the Effective Date, the Original Plan was split into two plans, one for key Executives and the other for non-employee directors of the Company, the Bank and members of their Controlled Group. The Plan, as described herein, is intended to amend and continue the Original Plan with respect to Eligible Executives.

**SECTION 1  
Definitions**

1.1 “**Account**” means any of the accounts or subaccounts established for each Participant pursuant to **Section 5.1**.

1.2 “**Annual Bonus**” shall mean compensation the amount of which, or the entitlement to which, is contingent on the satisfaction of preestablished organizational or individual performance criteria relating to a performance period of at least twelve (12) consecutive months (all as described in Treasury Regulations Section 1.409A-1(e)).

1.3 “**Beneficiary**” shall mean the person(s) Participant has designated in writing to the Committee to receive benefits under this Plan in the event of the Participant’s death. If the Participant has not specifically designated any Beneficiary for purposes of the Plan, then the Beneficiary shall be the Participant’s estate. In the case of the death of the Beneficiary before completion of payments under the Plan to the Beneficiary, then the Beneficiary’s estate shall become entitled to any remaining payments.

1.4 “**Board**” means the Board of Directors of the Company.

1.5 “**Change of Control**” shall mean the first to occur of the following:

A. Any Person (as defined in Sections 13(d) and 14(d) of the Exchange Act), other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company or a corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the beneficial owner (within the meaning of Rule 13d-3 of the Exchange Act), directly or indirectly, of securities representing fifty percent (50%) or more of



the total voting power represented by the Company's then outstanding Voting Stock;

B. During any period of twelve (12) consecutive months, individuals who at the beginning of such period constitute the Board and any new director whose election by the Board or nomination for election by the Company's stockholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof; or

C. Consummation of: (i) a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the Voting Stock of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; or (ii) a complete liquidation of the Company or the Bank or an agreement for the sale or disposition by the Company of all or substantially all the Company's or the Bank's assets.

However, in no event shall a Change of Control be deemed to have occurred, with respect to the Participant if the Participant is part of a purchasing group which consummates the Change of Control transaction. The Participant shall be deemed "part of a purchasing group" for purposes of the preceding sentence if the Participant is an equity participant in the purchase company or group (except for (i) passive ownership of less than two percent (2%) of the stock of the purchasing company; or (ii) ownership of equity participation in the purchasing company or group which is otherwise not significant, as determined prior to the Change of Control by a majority of the continuing Directors).

In the event that any amount under the Plan constitutes deferred compensation (as defined under Code Section 409A), and the settlement of, or distribution of such amount is to be triggered by a Change of Control, then such settlement or distribution shall be subject to the event constituting the Change of Control also constituting a "change in the ownership" or "change in the effective control" of the Company, as permitted under Code Section 409A.

1.6 "**Code**" shall mean the Internal Revenue Code of 1986, as amended.

1.7 "**Committee**" shall mean the Compensation Committee of the Board or any other committee of the Board as may be designated from time to time by the Board, or any designee of either.

1.8 "**Controlled Group**" shall mean any and all entities which share common ownership with the Company resulting in a "parent-subsidiary controlled group," as that term is defined by Code Section 1563(a)(1), or "brother-sister controlled group," as that term is defined by Code Section 1563(a)(2), or any "combined group," as that term is defined by Code Section 1563(a)(3).

1.9 "**Deferred Compensation**" shall mean Salary and Annual Bonus that is the subject of an elective deferral under **Section 4.1** of the Plan.

1.10 "**Deferred Compensation Account**" shall mean the bookkeeping account established for a Participant under the Plan to which Deferred Compensation with respect to such Participant is credited from time to time, as provided in **Section 5.3** of the Plan.

1.11 "**Director**" shall mean any person duly elected or appointed and serving as a director of the Company, the Bank or any other member of the Controlled Group and who is not a current employee of the Company, the Bank or any other member of the Controlled Group and has not been an employee of the Company, the Bank or any other member of the Controlled Group for at least one year.

1.12 “**Disability**” shall mean with respect to a Participant, that the Participant: (A) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, or (B) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three months under an accident or health plan covering employees or directors of such Participant’s employer, as determined in accordance with Code Section 409A(a)(2)(C) and the Treasury Regulations thereunder.

1.13 “**Distributable Amount**” of a Participant’s Accounts with respect to a Plan Year shall mean the sum of the Deferred Compensation and earnings, if any, thereon credited to a Participant’s Deferred Compensation Account, or any other accounts or subaccounts, with respect to such Plan Year.

1.14 “**Election Form**” shall mean the form (as set forth in EXHIBITS B-1 and B-2 to the Plan) which Participants use to defer Salary and Annual Bonus and to elect distribution options.

1.15 “**Election Period**” with respect to a Plan Year shall mean the period designated by the Committee; *provided, however*, that such period shall be no less than ten (10) business days. The Election Period with respect to a Plan Year shall end not later than the last day of the prior Plan Year; *provided, however*, that, in the case of a Participant who first becomes eligible to participate in the Plan during a Plan Year, the Election Period may be the thirty (30) day period commencing on the date such Participant first becomes eligible to participate in accordance with Code Section 409A(a)(4)(B)(ii) and the Treasury Regulations thereunder; *provided further*, that, with respect to Annual Bonus being deferred in accordance with the requirements of Treasury Regulations Section 1.409A-1(e), the Election Period may extend until a date on or before the date that is six (6) months before the end of the “performance period” (as described in Treasury Regulations Section 1.409A-1(e)).

1.16 “**Eligible Executive**” shall mean any Executive who is selected by the Committee to participate in the Plan, including any Executive who is also an Inside Director.

1.17 “**ERISA**” shall mean the Employee Retirement Income Security Act of 1974, as amended.

1.18 “**Exchange Act**” shall mean the Securities Exchange Act of 1934, as amended.

1.19 “**Executive**” shall mean any officer or other employee of the Company, the Bank or any other member of the Controlled Group whom the Committee, in its sole discretion, determines is a member of a select group of management or highly compensated employees.

1.20 “**Fair Market Value**” means, on any date, the officially-quoted closing selling price of the shares on such date on the principal national securities exchange on which the shares are listed or admitted to trading (including the New York Stock Exchange, Nasdaq Stock Market, Inc. or such other market or exchange in which such prices are regularly quoted) or, if there have been no sales with respect to the shares on such date, or if the shares are not so listed or admitted to trading, the Fair Market Value shall be the value established by the Committee in good faith and in accordance with Code Sections 422 and 409A.

1.21 “**Inside Director**” shall mean a Director of the Company, the Bank or any other member of the Controlled Group who is an employee of the Company, the Bank or any other member of the Controlled Group.

1.22 “**Measurement Fund**” shall mean one or more of the investment funds selected by the Committee.

1.23 “**Participant**” shall mean an Eligible Executive who has been selected by the Committee to participate in the Plan, and who has elected to participate in the Plan.

1.24 “**Participation Certificate**” shall mean that agreement (as set forth in EXHIBIT A to the Plan) entered into by a Participant and the Company prior to participation in the Plan.

1.25 “**Payment Date**” shall mean, unless otherwise designated by the Participant on his or her Election Form, the last day of the calendar month following the date of the Participant’s Separation from Service.

1.26 “**Plan Year**” shall mean the twelve (12) consecutive month period beginning on each January 1 and ending on each December 31.

1.27 “**Salary**” shall mean the regular annual base compensation paid by the Company, the Bank or any other member of the Controlled Group to an Eligible Executive (without regard to any reduction thereof pursuant to the Plan, but net of any reduction for applicable taxes and other benefits elected by such Eligible Executive including, but not limited to, those provided under a 401(k) plan or Code Section 125 flexible benefits plan maintained by the Company, the Bank or any other member of the Controlled Group), exclusive of Annual Bonus and any other incentive payments made by the Company, the Bank or any other member of the Controlled Group to such Eligible Executive.

1.28 “**Securities Act**” shall mean the Securities Act of 1933, as amended.

1.29 “**Separation from Service**” shall mean a Participant’s termination of employment, if such termination is a “separation from service” within the meaning of Code Section 409A(a)(2)(A)(i).

1.30 “**Specified Employee**” shall have the meaning set forth in Code Section 409A(a)(2)(B)(i) and Treasury Regulation Section 1.409A-1(i).

1.31 “**Treasury Regulations**” shall mean the regulations promulgated by the U.S. Department of Treasury under Chapter 26 of the U.S. Code of Federal Regulations or any successor thereto.

1.32 “**Unforeseeable Emergency**” shall mean a severe financial hardship to the Participant resulting from: (A) an illness or accident of the Participant, or the Participant’s spouse, Beneficiary, or dependent (as defined in Code Section 152, without regard to Code Sections 152(b)(1), (b)(2), and (d)(1)(B)); (B) loss of the Participant’s property due to casualty; or (C) other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the Participant’s control, as determined by the Committee, in its sole discretion, based on the relevant facts and circumstances and as provided for in Treasury Regulations §1.409A-3(i)(3) or any successor provision.

1.33 “**Voting Stock**” shall mean that class (or classes) of common stock entitled to vote in the election of the Company’s directors.

## **SECTION 2**

### **Eligibility and Participation**

2.1 Eligibility. Individuals eligible to participate in the Plan shall consist of Eligible Executives.

2.2 Participation. Participation in the Plan by Eligible Executives shall be determined by the Committee, in its sole discretion, and shall be subject to the terms and conditions of the Plan, the Election Form(s) and the Participation Certificate. All Participants in the Plan shall, prior to participation, execute a

Participation Certificate. Upon becoming a Participant in the Plan, a Participant shall continue to participate in the Plan until such time as (A) the Participant ceases to be an Eligible Executive, or (B) the Committee takes action to terminate the Eligible Executive's right to continued participation in the Plan.

### **SECTION 3 Administration**

3.1 General Powers of Administration. The Plan shall be administered by the Committee. The Committee is authorized to construe and interpret the Plan and promulgate, amend and rescind rules and regulations relating to the implementation, administration and maintenance of the Plan. Subject to the terms and conditions of the Plan, the Committee, in its sole discretion, shall make all determinations necessary or advisable for the implementation, administration and maintenance of the Plan. The Committee may designate persons other than members of the Committee to carry out the day-to-day ministerial administration of the Plan under such conditions and limitations as it may prescribe. The Committee's determinations with respect to Eligible Executives under the Plan need not be uniform and may be made selectively among Eligible Executives whether or not such Eligible Executives are similarly situated. Any determination, decision or action of the Committee in connection with the construction, interpretation, administration, implementation or maintenance of the Plan shall be final, conclusive and binding upon all Participants and any person(s) claiming any Plan benefits under or through any Participants.

3.2 Indemnification. The Company will indemnify and hold harmless the Committee, any Director or any employee charged with duties associated with the Plan against any cost or expense (including, without limitation, attorneys' fees) or liability (including, without limitation, any sum paid with the approval of the Company in settlement of a claim) arising out of any act or omission to act, except in the case of willful gross misconduct or gross negligence.

### **SECTION 4 Deferral Contributions**

4.1 Deferred Compensation. Participants may defer all or a portion of their Salary and Annual Bonus earned during any Plan Year, in accordance with the following provisions.

A. *Deferral Election*. To defer Salary or Annual Bonus during any particular Plan Year, during the Election Period, Participants must complete, execute and file with the Committee an Election Form.

B. *Content of Deferral Elections*. The following shall apply to all deferral elections:

(i) All deferral elections shall contain a statement that the Participant elects to defer all or a portion of such Participant's Salary and Annual Bonus, as the case may be, for a specified Plan Year or performance period, that are earned and become payable to the Participant after the filing of such deferral election;

(ii) Except for the provisions of **subsection (iii)** below, any deferral election shall apply only to the Salary and Annual Bonus, as the case may be, that is attributable to the Participant's services rendered to the Company during the Plan Year or performance period for which such election is made (whether or not such compensation is actually paid and received in such Plan Year or performance period), *provided that*, once a Participant has timely filed an Election Form in accordance with the Plan, such Election Form shall be effective for future Plan Years until modified or cancelled by the Participant in accordance with the Plan;

(iii) If a Participant has previously deferred Annual Bonus and fails to complete and return a Form on or before the date that is six (6) months before the end of the then-current “performance period” (as described in Treasury Regulations Section 1.409A-1(e)), then the deferral election with respect to Annual Bonus made by the Participant on the most recently filed Election Form shall be considered effective for such current performance period; and,

(iv) A Participant may cancel a deferral election for any Plan Year by filing with the Committee written notice of such cancellation prior to January 1 of the Plan Year in which such cancellation is to become effective, whereupon a Participant shall not be entitled to participate in the Plan for such Plan Year. A Participant may cancel a deferral election for any performance period by filing with the Committee written notice of such cancellation on or before the date that is six (6) months before the end of the then-current “performance period” (as described in Treasury Regulations Section 1.409A-1(e)), whereupon a Participant shall not be entitled to participate in the Plan for such performance period. Such a Participant may, however, participate with respect to future Plan Years or performance periods, as the case may be, by filing a new Election Form in accordance with the Plan.

## **SECTION 5**

### **Plan Accounts**

5.1 Establishment of Plan Accounts. The Company shall establish on behalf of each Participant a Deferred Compensation Account and such other accounts and subaccounts as the Committee, in its sole discretion, shall determine from time to time.

5.2 Election of Measurement Funds in Deferred Compensation Account. In the manner designated by the Committee, Participants may elect one or more Measurement Funds to be used to determine the additional amounts to be credited to their Deferred Compensation Account. The Committee shall select from time to time, in the Committee’s sole discretion, the Measurement Funds to be available under the Plan. Notwithstanding any other provision of the Plan to the contrary, the Measurement Funds are to be used for measurement purposes only, and a Participant’s election of any such Measurement Fund, the allocation to his Deferred Compensation Account thereto, the calculation of additional amounts and the crediting or debiting of such amounts to a Participant’s Deferred Compensation Account shall not be considered or construed in any manner as an actual investment of his Deferred Compensation Account in any such Measurement Fund. In the event that the Company, in its own discretion, decides to invest funds in any or all of the Measurement Funds, no Participant shall have any rights in or to such investments themselves. Without limiting the foregoing, a Participant’s Deferred Compensation Account shall at all times be a bookkeeping entry only and shall not represent any investment made on his or her behalf by the Company. The Participant shall at all times remain an unsecured creditor of the Company.

A. *Investment Elections.* Participants may designate how their Deferred Compensation Account, if any, shall be deemed to be invested under the Plan.

(i) Such Participants may make separate investment elections for their future deferrals, and the existing balances of their Deferred Compensation Account.

(ii) Such Participants may make and change their investment elections by choosing from the Measurement Funds designated by the Committee in accordance with the procedures established by the Committee.

(iii) Except as otherwise designated by the Committee, the available Measurement Funds under **Section 5.2** above shall generally be the same as, or similar to, investment funds under the Midland States Bank 401(k) Profit Sharing Plan (excluding any brokerage account option).

(iv) If a Participant fails to elect a Measurement Fund under this Section, he or she shall be deemed to have elected the Qualified Default Investment Alternative (or other default investment alternative) specified from time-to-time in the Midland States Bank 401(k) Profit Sharing Plan for his Deferred Compensation Account.

B. *Continuing Investment Elections.* Participants who have had a Separation from Service but not yet commenced distributions under the Plan or Participants who are receiving installment payments may continue to make investment elections pursuant to **subsection A** above, as applicable, except as otherwise determined by the Committee; *provided, however*, if the Participant's Separation from Service is for cause, as determined pursuant to a Participant's employment agreement or otherwise by the Committee in its sole discretion, no earnings shall accrue to such Participant's Deferred Compensation Account for any period of time following the Participant's Separation from Service.

5.3 Credit to Deferred Compensation Account. A Deferred Compensation Account shall be created for each Participant, to which all Deferred Compensation shall be credited.

A. *Initial Credit to Deferred Compensation Account.* Each Participant's Deferred Compensation Account shall be credited no less frequently than the first business day of each calendar quarter with an amount equal to the sum of the Deferred Compensation deferred by the Participant during the preceding calendar quarter in accordance with **Section 4.1** of the Plan.

B. *Earnings Credit to Account.* Each Deferred Compensation Account shall be divided into separate investment fund subaccounts, each of which corresponds to a Measurement Fund elected by the Participant. The performance of each elected Measurement Fund (either positive or negative) shall be determined by the Committee, based on the performance of the Measurement Funds themselves. A Participant's Deferred Compensation Account shall be credited or debited on each December 31<sup>st</sup>, or more frequently as determined by the Committee, based on the performance of each Measurement Fund selected by the Participant, as though (a) a Participant's Deferred Compensation Account and the underlying separate investment fund subaccounts were invested in the Measurement Fund(s) selected by the Participant, in the percentages applicable to such period, as of the close of business on the first business day of such period, at the closing price on such date, (b) the portion of the Participant's Deferred Compensation that was actually deferred during any period were invested in the Measurement Fund(s) selected by the Participant, in the percentages applicable to such period, no later than the close of business on the first business day after the day on which such amounts are actually deferred, at the closing price on such date, and (c) any withdrawal or distribution made to a Participant that decreases such Participant's Deferred Compensation Account ceased being invested in the Measurement Fund(s), in the percentages applicable to such period, no earlier than one business day prior to the distribution, at the closing price on such date. The Committee shall establish and maintain, with respect to a Participant's Deferred Compensation Account, an additional subaccount with respect to each Plan Year, to which shall be credited the amount equal to the portion of the Participant's Deferred Compensation for such Plan Year, debited by amounts equal to distributions to and withdrawals made by the Participant and adjusted for investment earnings and losses as described herein.

## SECTION 6

## Vesting of Plan Accounts

Subject to **Section 10.12** below, a Participant's Accounts shall vest in accordance with the following:

6.1 *Deferred Compensation Account.* A Participant's Deferred Compensation Account shall at all times be 100% vested.

6.2 *Other Accounts and Subaccounts.* Any other accounts or subaccounts established by the Committee from time to time shall vest in accordance with the terms and conditions established by the Committee.

## SECTION 7 Payment to Participants

7.1 General Rule. Unless otherwise determined by the Committee in its sole discretion, each Participant shall make a separate distribution election with respect to each Plan Year for which such Participant elects to defer Salary or Annual Bonus. A Participant's distribution election with respect to a Plan Year shall apply to his or her Deferred Compensation Account as well as each account or subaccount in the Deferred Compensation Account. A Participant's Election Form with respect to a Plan Year shall specify the Payment Date and the form of distribution of his or her Distributable Amount with respect to such Plan Year. Any distribution to a Participant pursuant to the Plan shall be made or commence on such Participant's Payment Date.

The limitations under this subsection shall be applied in accordance with Code Section 409A(a)(4)(C) and the Treasury Regulations thereunder.

A. *Normal Form.* Except as provided in **paragraph B** below, a Participant's Distributable Amount with respect to each Plan Year shall be paid to the Participant in a single lump sum in cash on the Participant's Payment Date.

B. *Optional Forms.* Instead of receiving his or her Distributable Amount with respect to each Plan Year in the form of a single lump sum, the Participant may elect an optional form of payment (on the Election Form) at the time of the Participant's deferral election for such Plan Year. The Participant may elect on his or her timely executed and filed Election Form to receive the Distributable Amount in equal monthly installments over a period of two (2) to fifteen (15) years beginning on the Participant's Payment Date. The payment of such Participant's Distributable Amount with respect to each Plan Year shall be made or commence on such Participant's Payment Date.

All installment payments made under the Plan shall be determined in accordance with the annual fractional payment method, calculated as follows: the balance of the Participant's Accounts with respect to a Plan Year shall be calculated as of the date of distribution. The annual installment shall be calculated by multiplying this balance by a fraction, the numerator of which is one, and the denominator of which is the remaining number of annual payments due to the Participant. By way of example, if the Participant elects 10 annual installments for the distribution of his or her Accounts with respect to a Plan Year, the first payment shall be 1/10 of the balance of such Accounts calculated as described in this paragraph. The following year, the payment shall be 1/9 of the balance of the Participant's Accounts, calculated as described in this paragraph. The final distribution shall be based on 100% of the balance of the Participant's Accounts as of the date of distribution.

The amount of each monthly installment shall then be determined by further dividing the annual

installment with respect to any particular year by 12 to arrive at the amount of each monthly installment. Each monthly installment shall be paid on the last business day of the applicable month. The Committee may, in its sole discretion, adjust an elected distribution schedule in an effort to avoid any potential violation of Code Section 409A.

7.2 Death Before Payment of Benefits. If a Participant dies before the balance of the Participant's Accounts has been paid to the Participant, any remaining payments will be made to the Participant's Beneficiary in the same form and manner as they would have been made to the Participant under the provisions of **Section 7.1** above.

7.3 Distributions in Cases of Hardship. Notwithstanding the provisions of **Section 7.1** above, the Committee may, in its sole discretion, choose to permit a Participant to withdraw amounts from his or her vested Accounts upon a showing by such Participant that an Unforeseeable Emergency has occurred. Such distribution shall be limited to the amount shown to be necessary to meet the Unforeseeable Emergency, and no more than one withdrawal will be permitted from a Participant's Accounts during any Plan Year.

Any amounts distributed to a Participant pursuant to an Unforeseeable Emergency shall be considered to be taxable compensation to the Participant in the Plan Year of withdrawal.

7.4 Prohibition on Acceleration of Distributions. Subject to **Section 7.5** below, the time or schedule of payment of any withdrawal or distribution under the Plan shall not be subject to acceleration, except as provided under Treasury Regulations promulgated in accordance with Code Section 409A.

7.5 Re-deferrals and Changing the Form of Payment. In accordance with procedures established from time-to-time by the Committee in its sole discretion, the Participant may make an election to re-defer all or a portion of the amounts in his or her Deferred Compensation Account until a later distribution date or to change the form of a payment (a "**Re-deferral Election**"); *provided* that, the following requirements are met:

A. The Re-deferral Election is made at least twelve (12) months before the original distribution date;

B. The distribution date for the re-deferred amounts is at least five (5) years later than the original distribution date; and

C. The Re-deferral Election will not take effect for at least twelve (12) months after the Re-deferral Election is made.

7.6 Limited Cashouts. Notwithstanding any provision of the Plan or any Participant election to the contrary, the Committee may accelerate payment of a Participant's Account(s) to the extent that (i) the aggregate amount of the Participant's Account(s) does not exceed the applicable dollar amount under Code Section 402(g)(1)(B), (ii) the payment results in the termination of the Participant's entire interest in the Plan and any plans that are aggregated with the Plan pursuant to Treas. Reg. Section 1.409A-1(c)(2), and (iii) the Committee's decision to cash out the Participant's Account(s) is evidenced in writing no later than the date of payment.

7.7 Specified Employee. Notwithstanding anything in the Plan to the contrary, if a Participant is a Specified Employee as of the date of his or her Separation from Service, then no distribution of such Participant's Account shall be made upon the Participant's Separation from Service until the first payroll date of the seventh month following the Participant's Separation from Service (or, if earlier, upon the date of the Participant's death) (the "**Specified Employee Payment Date**"). Any payments to which a Specified



Employee otherwise would have been entitled under the Plan during the period between the Participant's Separation from Service and the Specified Employee Payment date shall be accumulated and paid in a lump sum payment on the Specified Employee Payment Date.

## **SECTION 8 Participant Statements**

8.1 Annual Participant Statements. Within a reasonable period of time following the end of each Plan Year, each Participant shall be provided with a statement showing the balances (vested and nonvested) in the Participant's Deferred Compensation Account.

8.2 Termination of Participant's Employment. Within 30 days following the date of the Participant's termination of employment (for any reason), the Participant shall be provided with a statement showing the vested balances of his or her Deferred Compensation Account as of the date of such Separation from Service.

## **SECTION 9 Amendment or Termination of Plan**

Any amendment to this Plan shall be made pursuant to a duly adopted resolution of the Board; *provided, however,* that if such amendment directly or indirectly affects the benefits payable under the Plan, such amendment must be mutually agreed to in writing by a Participant (or, in the event that such Participant is deceased at the date of amendment, the Beneficiary). Notwithstanding the foregoing, at the time of a Change of Control, the Board may unilaterally terminate and distribute all Accounts in accordance with Code Section 409A.

## **SECTION 10 General Provisions**

10.1 Participant's Rights Unfunded. The Plan at all times shall be unfunded as defined under provisions of the Code. The right of any Participant or Beneficiary to receive a distribution hereunder shall be an uninsured claim against the general assets of the Company in the event of the Company's insolvency or bankruptcy. The Company may implement a form of trust arrangement (known generally as a "rabbi trust") to hold the Company assets which will be used to make payments to the Participant (or any Beneficiary) under the terms of the Plan. Such trust arrangement will not be a "funded" arrangement under the provisions of the Code.

10.2 Independence of Other Benefit Arrangements. Participation in the Plan shall in no way restrict or otherwise impact Participant's participation in any other welfare benefit plan, employment or other contract, deferred compensation arrangement, equity participation plan or any other form of retirement benefit arrangement sponsored by the Company.

10.3 No Secured Guarantee of Benefits. In the event of the insolvency or bankruptcy of the Company, Participant shall remain a general creditor of the Company with respect to any benefits payable under the Plan, and nothing contained in the Plan shall constitute a secured guaranty by the Company or any other person or entity that the assets of the Company will be sufficient to pay any benefit hereunder in the event of the Company's insolvency or bankruptcy.

10.4 No Enlargement of Rights. No Participant shall have any right to receive a distribution of any benefits under the Plan except in accordance with the terms of the Plan. Establishment of the Plan shall not be construed to give any Participant the right to be retained in the service of the Company or any other

member of the Controlled Group, whether as an employee, officer or director.

10.5 Spendthrift Provision. No interest of any person or entity in, or right to receive a distribution under the Plan shall be subject in any manner to sale, transfer, assignment, pledge, attachment, garnishment or other alienation or encumbrance of any kind; nor may such interest or right to receive a distribution be taken, either voluntarily or involuntarily, for the satisfaction of the debts of, or other obligations or claims against, such person or entity, including claims for alimony, support, separate maintenance and claims in bankruptcy proceedings.

10.6 Applicable Law. The Plan shall be construed and administered under the laws of the State of Illinois.

10.7 Severability. In the event that any of the provisions of the Plan are held to be inoperative or invalid by any court of competent jurisdiction, then: (i) insofar as is reasonable, effect will be given to the intent manifested in the provision held invalid or inoperative; and (ii) the validity and enforceability of the remaining provisions of the Plan will not be affected thereby.

10.8 Incapacity of Recipient. If any person entitled to a distribution under the Plan is deemed by the Committee to be incapable (physically or mentally) of personally receiving and giving a valid receipt for any payment pursuant to the Plan, then, unless and until claim therefore shall have been made by a duly appointed guardian or other legal representative of such person, the Company may provide for such payment or any part thereof to be made to any other person or institution then contributing towards or providing for the care and maintenance of such person. Any such payment shall be a payment for the account of such person and a complete discharge of any liability of the Company and the Plan with respect to such payment.

10.9 Successors. The terms and conditions of the Plan will be binding on the Company's and Participant's successors, heirs and assigns.

10.10 Unclaimed Benefits. Participant shall keep the Company informed of his or her current address and the current address of his or her Beneficiary. The Company shall not be obligated to search for the whereabouts of any person. If the location of any Participant is not made known to the Company within a one (1) year period after the date on which payment is to be made under the provisions of **Section 7.1**, then payment may be made by the Company to the Beneficiary instead. If, within one (1) additional year after such initial one (1) year period, the Company is unable to locate any designated Beneficiary of the Participant, then the Company shall use its reasonable best efforts to distribute all unclaimed benefits to the estate or other representative of the Participant.

10.11 Limitations on Liability. Participant and any other person claiming benefits under the Plan shall be entitled under this Plan only to those payments provided in accordance with the provisions of the Plan ("**Payment Claims**"). With the exception of the provisions of **Section 10.13** of the Plan, neither the Company, the Company Successor nor any individual acting as an employee or agent of the Company or the Company Successor, shall be liable to Participant or any other person for any other claim, loss, liability or expense under this Plan not directly related to a Payment Claim.

10.12 Forfeiture of Benefits. Notwithstanding any other provision of the Plan, should Participant engage in theft, fraud or embezzlement causing significant property damage to the Company, then any benefits payable to such Participant under the Plan will automatically be forfeited. The determination of theft or embezzlement will be made by the Board in good faith, but such determination does not require an actual criminal indictment or conviction prior to or after such decision. In any determination of forfeiture pursuant to this **Section 10.12**, the Participant will be given the opportunity to refute any such decision by

the Board, but the Board's decision on the matter will be considered final and binding on Participant and all other parties.

10.13 Payment of Attorneys' Fees, Court Costs, and Interest on Loss of Benefits. Should either the Company or the Company Successor or a Participant bring an action at law (or through arbitration) in order that the Plan's terms be enforced, then the party prevailing in the action at law (or through arbitration) shall be entitled to reimbursement from the losing party for reasonable attorneys' fees, court costs and other similar amounts expended in the enforcement of the terms of the Plan. In addition, should the prevailing party be the Participant, he or she shall also be entitled to interest on any delayed payments, with such interest computed in accordance with **Section 5.3** above.

10.14 Withholding. There shall be deducted from all payments under the Plan the amount of any taxes required to be withheld by any federal, state or local government. The Participants, any Beneficiaries and personal representatives shall bear any and all federal, foreign, state, and local, income or other taxes imposed on amounts paid under the Plan.

10.15 Participants Bound By Terms of the Plan. Each Participant shall be deemed conclusively to have accepted and consented to all terms of the Plan and all actions or decisions made by the Company with regard to the Plan. Such terms and consent shall also apply to and be binding upon any Beneficiaries, personal representatives and successors of each Participant. Each Participant shall receive a copy of the Plan.

10.16 Code Section 409A. The Company intends that the Plan comply with the requirements of Code Section 409A and shall be operated and interpreted consistent with that intent. Notwithstanding the foregoing, the Company makes no representation that the Plan complies with Code Section 409A and shall have no liability to any Participant for any failure to comply with Code Section 409A. The Plan shall constitute an "account balance plan" as defined in Treasury Regulation Section 31.3121(v)(2)-1(c)(1)(ii)(A). For purposes of Code Section 409A, all amounts deferred under this Plan shall be aggregated with amounts deferred under other account balance plans.

## **SECTION 11**

### **Claims Procedures**

11.1 Presentation of Claim. Any Participant or Beneficiary of a deceased Participant (such Participant or Beneficiary being referred to below as a "**Claimant**") may deliver to the Committee a written claim for a determination with respect to the amounts distributable to such Claimant from the Plan. If such a claim relates to the contents of a notice received by the Claimant, the claim must be made within sixty (60) days after such notice was received by the Claimant. All other claims must be made within one hundred-eighty (180) days of the date on which the event that caused the claim to arise occurred. The claim must state with particularity the determination desired by the Claimant.

11.2 Notification of Decision. The Committee shall consider a Claimant's claim within a reasonable time, but no later than ninety (90) days; *provided* that claims based on Disability shall be considered within forty-five (45) days, unless, within such time, the Committee notifies the Claimant in writing that an extension is required pursuant to Labor Regulation 2560.503-1 (up to ninety (90) days for non-Disability claims and thirty (30) days for Disability claims). Once a decision is made, the Committee shall notify the Claimant in writing:

A. That the Claimant's requested determination has been made, and that the claim has been allowed in full; or

B. That the Committee has reached a conclusion contrary, in whole or in part, to the Claimant's requested determination, and such notice must set forth in a manner calculated to be understood by the Claimant:

- (i) the specific reason(s) for the denial of the claim, or any part of it;
- (ii) the specific reference(s) to pertinent provisions of the Plan upon which such denial was based;
- (iii) a description of any additional material or information necessary for the Claimant to perfect the claim, and an explanation of why such material or information is necessary; and
- (iv) an explanation of the claim review procedure set forth in **Section 11.3** below, including the Claimant's right to bring a civil action under ERISA Section 502(a) as described in **Section 11.5** below.

11.3 Review of a Denied Claim. Within sixty (60) days (one hundred-eighty (180) days for a claim based on Disability) after receiving a notice from the Committee that a claim has been denied, in whole or in part, a Claimant (or the Claimant's duly authorized representative) may file with the Committee a written request for a review of the denial of the claim. Thereafter, but not later than thirty (30) days after the review procedure began, the Claimant (or the Claimant's duly authorized representative):

- A. may review pertinent documents;
- B. may submit written comments or other documents; and/or
- C. may request a hearing, which the Committee, in its sole discretion, may grant.

11.4 Decision on Review. The Committee shall render its decision on review promptly, and not later than sixty (60) days (forty-five (45) days for a claim based on Disability) after the filing of a written request for review of the denial, unless a hearing is held or other special circumstances require additional time, in which case the Committee's decision must be rendered within one hundred-twenty (120) days after such date; *provided* that this period shall include up to one (1) forty-five (45)-day extension for claims based on Disability. Such decision must be written in a manner calculated to be understood by the Claimant, and it must contain:

- A. specific reasons for the decision;
  - B. specific reference(s) to the pertinent Plan provisions upon which the decision was based;
- and
- C. such other matters as the Committee deems relevant.

11.5 Legal Action. A Claimant's compliance with the foregoing provisions of this **Section 11** is a mandatory prerequisite to a Claimant's right to commence any legal action with respect to any claim for benefits under this Plan.

EXHIBIT A

**Deferred Compensation Plan for Executives  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

PARTICIPATION CERTIFICATE

THIS PARTICIPATION CERTIFICATE certifies that the Compensation Committee of the Board of Directors of Midland States Bancorp, Inc. has selected ("Participant") as a Participant in the Deferred Compensation Plan For Executives of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), with all of the rights and privileges appurtenant thereto.

By signing this Certificate in the space provided below, Participant acknowledges having received a copy of the Plan and having read and reviewed the terms and provisions thereof.

Dated as of the \_\_\_\_\_ day of , 20\_\_.

MIDLAND STATES BANCORP, INC.

By:

Title:

Received by Participant the \_\_\_ day of \_\_\_\_\_, 20\_\_.

\_\_\_\_\_  
[Name of Participant]

\_\_\_\_\_  
Address

\_\_\_\_\_  
City, State and Zip Code

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EXHIBIT B-1

**Deferred Compensation Plan for Executives  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

DEFERRED COMPENSATION ELECTION FORM

Pursuant to the Deferred Compensation Plan For Executives of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby elect the following actions in conjunction with my employment with Midland States Bancorp, Inc. or one of its subsidiaries. Unless the context clearly requires otherwise, capitalized terms herein shall have the same meanings as ascribed to them under the Plan.

- Deferrals:
  - Salary otherwise payable to me for the 20\_\_\_\_ Plan Year in the aggregate amount of  all, or  \$\_\_\_\_\_, or  \_\_\_\_\_% thereof, and/or
- Timing of Distributions (Participant Payment Date) (**select one**):
  - Date Certain Election: For all deferrals for the 20\_\_\_\_ Plan Year, I elect payment on the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year), or
  - Separation from Service: For all deferrals for the 20\_\_\_\_ Plan Year, I elect payment only upon a Separation from Service, or
  - I elect payment on earlier of the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year) or upon a Separation from Service.
- Method of Distribution (**select one**):
  - Monthly installments over \_\_\_\_\_ years (minimum of 2, maximum of 15).
  - Lump-sum.

The elections specified above (if any) will continue in effect for future years until revoked.

Date:

Signature

Print Name

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EXHIBIT B-2

**Deferred Compensation Plan for Executives  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

DEFERRED COMPENSATION ELECTION FORM

Pursuant to the Deferred Compensation Plan For Executives of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby elect the following actions in conjunction with my employment with Midland States Bancorp, Inc. or one of its subsidiaries. Unless the context clearly requires otherwise, capitalized terms herein shall have the same meanings as ascribed to them under the Plan.

· Deferrals:

- Annual Bonus otherwise earned by me during the \_\_\_\_ annual performance period in the aggregate amount of  all, or  \$\_\_\_\_\_, or  \_\_\_\_\_% thereof.

**The elective deferral made pursuant to this Form is with respect to Annual Bonus only. "Annual Bonus" is, generally, compensation the amount of which, or the entitlement to which, is contingent on the satisfaction of preestablished organizational or individual performance criteria relating to a performance period of at least twelve (12) consecutive months (all as described in Treasury Regulations Section 1.409A-1(e)).**

· Timing of Distributions (Participant Payment Date) (*select one*):

- Date Certain Election: For all deferrals for the \_\_\_\_ annual performance period, I elect payment on the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year), or
- Separation from Service: For all deferrals for the \_\_\_\_ annual performance period, I elect payment only upon a Separation from Service, or
- I elect payment on earlier of the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year) or upon a Separation from Service.

· Method of Distribution (*select one*):

- Monthly installments over \_\_\_\_\_ years (minimum of 2, maximum of 15).
- Lump-sum.

The elections specified above (if any) will continue in effect for future annual performance periods until revoked.

Date:

Signature

Print Name

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EXHIBIT B-3

**Deferred Compensation Plan for Executives  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

BENEFICIARY DESIGNATION FORM

Pursuant to the Deferred Compensation Plan For Executives of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby designate the following persons as my beneficiaries to receive all amounts held for me under the Plan which have not been paid to me at the date of my death:

Primary Beneficiary(ies):

Name:

Name:

Relationship:

Relationship:

Percentage:

Percentage:

Secondary Beneficiary(ies)

Name:

Name:

Relationship:

Relationship:

Percentage:

Percentage:

The designation of beneficiaries specified above (if any) will continue in effect for future years until revoked.

Date:

Signature

Print Name

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EXHIBIT B-4

**Deferred Compensation Plan for Executives  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)**

REQUEST FOR HARDSHIP WITHDRAWAL

Pursuant to the Deferred Compensation Plan For Executives of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby request a hardship withdrawal from the balance in my Deferred Compensation Account relative to the \_\_\_\_\_ Plan Year in the amount of \$ \_\_\_\_\_ as a result of the occurrence of an Unforeseeable Emergency, as more particularly described on the page attached hereto.

Date:

Signature

Print Name

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Deferred Compensation Plan for Executives  
of Midland States Bancorp, Inc.  
(Effective November 8, 2018)

RE-DEFERRAL ELECTION FORM

Pursuant to the Deferred Compensation Plan For Executives of Midland States Bancorp, Inc., effective November 8, 2018 (the "Plan"), a copy of which I have in my possession and have read, I hereby elect the following actions with respect to amounts that I have previously deferred under the Plan. Unless the context clearly requires otherwise, capitalized terms herein shall have the same meanings as ascribed to them under the Plan.

**Previous Deferral Election:**

- This Re-Deferral Election is made with respect to (***select only one***):
  - Salary otherwise payable to me for the 20\_\_\_\_ Plan Year
  - Annual Bonus otherwise earned by me during the \_\_\_\_ annual performance period
- With respect to the Salary or Annual Bonus identified above, I originally elected to receive such deferrals:
  - In the form of (***select only one***):
    - monthly installments over \_\_\_\_\_ years, or
    - a lump sum
  - With such payment originally scheduled to commence (***select only one***):
    - Date Certain Election: On the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year), or
    - Upon a Separation from Service, or
    - Upon the earlier of the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year) or a Separation from Service.

**Re-Deferral Election:**

- In the form of (***select only one***):
  - monthly installments over \_\_\_\_\_ years, or
  - a lump sum
- With such payment re-deferred until (***select only one***):
  - Date Certain Election (must be at least five (5) years later than originally elected Date Certain Election identified above): On the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year), or
  - Five (5) years after my Separation from Service, or
  - Upon the earlier of the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year) (any new specified date must be at least five (5) years later than the originally elected date) or a Separation from Service, or
  - (*Available only in limited circumstances*) Upon the later of five years following a Separation from Service or the last day of \_\_\_\_\_ (month) \_\_\_\_\_ (year)

[Signature page follows]

By signing below, I acknowledge that: (i) this Re-Deferral Election Form is being executed by me at least twelve (12) months prior to the time I would otherwise be entitled to receive the Salary or Annual Bonus identified above; (ii) this Re-Deferral Election Form will not take effect until the date that is twelve (12) months after this Re-Deferral Election Form has been executed and presented to the Plan administrator; and (iii) if I have incorrectly completed this Re-Deferral Form, the Plan administrator has no obligation to accept

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it as an effective Re-Deferral Election. I further acknowledge and agree that this Re-Deferral Election will not be effective until acknowledged and accepted by Human Resources at Midland States Bancorp, Inc.

You must attach a copy of your originally submitted Deferred Compensation Election Form to this Re-Deferral Election Form.

Date:

Signature

Print Name

Acknowledged and accepted by Human Resources at Midland States Bancorp, Inc.

Date:

Signature

Print Name

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## Employment Agreement

This **Employment Agreement** (this “**Agreement**”) is made and entered into as of December 20, 2012 (the “**Effective Date**”) by and between Midland States Bank, an Illinois banking corporation (the “**Employer**”) and Jeffrey Mefford (the “**Executive**”).

### Recitals

A. The Employer is a wholly-owned subsidiary of Midland States Bancorp, Inc., (the “**Company**”).

B. Executive is currently employed as Senior Vice President Community Banking of the Employer pursuant to the terms and conditions of that certain employment agreement by and between the parties dated December 1, 2010 (the “**Prior Agreement**”).

C. The Company is considering various strategic initiatives, one of which may be an initial public offering (an “**IPO**”) of its common stock pursuant to which the Company would become a publicly-traded corporation.

D. In anticipation of the possibility of an IP, or other strategic initiatives, the parties desire to reconsider, amend and restate the terms and conditions of employment applicable to Executive’s employment with the Employer.

**Now, therefore,** in consideration of the premises and of the covenants and agreements hereinafter contained, it is covenanted and agreed by and between the parties hereto as follows:

### Agreements

1. **Prior Agreement.** As of the Effective Date, the Agreement shall supersede and replace any and all prior agreements respecting Executive’s employment by, or service to, the Employer or the Company as may from time to time have been made by and between the parties, whether or not in writing, including but not limited to the Prior Agreement; *provided, however,* that any vested benefits due to Executive pursuant to any pension plan, welfare benefit plan or any other employee benefit plan shall continue to be available to Executive subject to the terms and conditions of the applicable plan as may be in effect from time to time.

2. **Employment Period.** Subject to the terms and conditions of this Agreement, the Employer hereby agrees to continue to employ Executive during the Employment Period and Executive hereby agrees to continue to remain in the employ of the Employer and to provide services during the Employment Period in accordance with this Agreement. The “**Employment Period**” shall be the period commencing on the Effective Date and ending two (2) years thereafter, unless sooner terminated as provided herein. As of the first anniversary of the Effective Date, and each anniversary thereafter (each an “**Extension Date**”), the Employment Period shall automatically be extended for one (1) additional year, unless either the Employer or the Executive notifies the other party, by written notice delivered no later than 90 days prior to such Extension Date, that the “**Employment Period**” shall not be extended for an additional year. Notwithstanding anything contained herein to the contrary, if a Change of Control occurs during

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the Employment Period, this Agreement shall remain in effect for the two (2) year period following the Change of Control and shall then terminate.

**3. Duties.** Executive agrees that during the Employment Period, Executive will devote his/her full business time, energies and talents to serving as the Senior Vice President Community Banking of the Employer, at the direction of the Chief Executive Officer of the Employer (the "CEO"). Executive shall have such duties and responsibilities as may be assigned to Executive from time to time by the CEO, which duties and responsibilities shall be commensurate with Executive's position, shall perform all duties assigned to Executive faithfully and efficiently, subject to the direction of the CEO, and shall have such authorities and powers as are inherent to the undertakings applicable to Executive's position and necessary to carry out the responsibilities and duties required of Executive hereunder. Executive will perform the duties required by this Agreement at the Company's principal place of business unless the nature of such duties requires otherwise. Notwithstanding the foregoing, during the Employment Period, Executive may devote reasonable time to activities other than those required under this Agreement, including activities of a charitable, educational, religious or similar nature (including professional associations) to the extent such activities do not, in the reasonable judgment of the CEO, inhibit, prohibit, interfere with or conflict with Executive's duties under this Agreement or conflict in any material way with the business of the Employer and its Affiliates; *provided, however*, that Executive shall not serve on the board of directors of any business (other than the Employer or its Affiliates) or hold any other position with any business without receiving the prior written consent of the CEO.

**4. Compensation and Benefits.** Subject to the terms and conditions of this Agreement, during the Employment Period, while Executive is employed by the Employer, the Employer shall compensate Executive for Executive's services as follows for periods following the Effective Date:

(a) Executive shall be compensated at an annual rate of \$220,000 (the "**Annual Base Salary**"), which shall be payable in accordance with the Employer's normal payroll practices as are in effect from time to time. Beginning on January 1, 2012 and on each anniversary of such date, Executive's rate of Annual Base Salary shall be reviewed by the CEO, and following such review, the Annual Base Salary may be adjusted upward but in no event will it be decreased.

(b) Executive shall be entitled to receive performance based annual incentive bonuses (each, the "**Incentive Bonus**") from the Employer for each fiscal year ending during the Employment Period. Any such Incentive Bonus shall be paid to Executive within thirty (30) days of the completion of the annual audit by the Employer's auditor, but in no event later than two and one-half months after the close of each such fiscal year. Executive's target Incentive Bonus shall be not less than thirty-five percent (35%) of the Annual Base Salary, which Incentive Bonus shall be determined by specific performance criteria established from time to time by the CEO.

(c) Executive shall be eligible to participate, subject to the terms and conditions thereof, in all other incentive plans and programs, including such cash and deferred bonus programs and equity incentive plans as may be in effect from time to time with respect to senior executives employed by the Employer on as favorable a basis as provided to other similarly situated senior executives. Executive and Executive's dependents, as the case may be, shall be

eligible to participate in all pension and similar benefit plans (qualified, non-qualified and supplemental), profit sharing, 401(k), as well as all medical and dental, disability, group and executive life, accidental death and travel accident insurance, and other similar welfare benefit plans and programs of the Employer, subject to the terms and conditions thereof, as in effect from time to time with respect to senior executives employed by the Employer on as favorable a basis as provided to other similarly situated senior executives.

(d) Executive shall be entitled to accrue vacation at a rate of no less than four (4) weeks paid vacation for each calendar year, subject to the Employer's vacation programs and policies as may be in effect during the Employment Period.

(e) Executive shall be reimbursed by the Employer, on terms and conditions that are substantially similar to those that apply to other similarly situated executives of the Employer, for reasonable out-of-pocket expenses for entertainment, travel, meals, lodging and similar items which are consistent with the Employer's expense reimbursement policy and actually incurred by Executive in the promotion of the Employer's business.

5. **Definitions.** As used throughout this Agreement, all of the terms defined in this Section 5 shall have the meanings given below.

(a) **"Affiliate"** shall mean each company, corporation, partnership, bank, savings bank, savings and loan association, credit union or other financial institution, directly or indirectly, which is controlled by, controls, or is under common control with, the Company, where "control" means (x) the ownership of 51% or more of the voting securities or other voting interest or other equity interest of any corporation, partnership, joint venture or other business entity, or (y) the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such corporation, partnership, joint venture or other business entity.

(b) **"Base Compensation"** shall mean the amount of equal to the sum of (i) the greater of Executive's then-current Annual Base Salary or Executive's Annual Base Salary as of the date one (1) day prior to the Change of Control; and (ii) the average of the Incentive Bonus paid (or payable) for the three (3) most recently completed fiscal years of the Company.

(c) **"Change of Control"** shall mean the first to occur of the following:

(i) Any Person, other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company or a corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the beneficial owner (within the meaning of Rule 13d-3 of the Exchange Act), directly or indirectly, of securities representing fifty percent (50%) or more of the total voting power represented by the Company's then outstanding Voting Securities; or

(ii) During any period of twelve (12) consecutive months, individuals who at the beginning of such period constitute the Board of Directors of the Company and any new Director whose election by the Board of Directors or nomination for election by the Company's stockholders was approved by a vote of at least two-thirds (2/3) of the Directors then still in office who either were Directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof; or

(iii) Consummation of: (i) a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into Voting Securities of the surviving entity) at least fifty percent (50%) of the total voting power represented by the Voting Securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; or (ii) a complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all the Company's assets.

However, in no event shall a Change in Control be deemed to have occurred, with respect to the Executive if the Executive is part of a purchasing group which consummates the Change-in-Control transaction. The Executive shall be deemed "part of a purchasing group" for purposes of the preceding sentence if the Executive is an equity participant in the purchase company or group (except for (i) passive ownership of less than two percent (2%) of the stock of the purchasing company; or (ii) ownership of equity participation in the purchasing company or group which is otherwise not significant, as determined prior to the Change in Control by a majority of the non-employee continuing Directors).

In the event that any benefit under this Agreement constitutes deferred compensation, and the settlement of, or distribution of such benefits is to be triggered by a Change in Control, then such settlement or distribution shall be subject to the event constituting the Change in Control also constituting a "change in the ownership" or "change in the effective control" of the Company, as permitted under Code Section 409A.

(d) **"Covered Period"** shall mean the period beginning six (6) months prior to a Change of Control and ending twenty-four (24) months after the Change of Control.

(e) **"Disability"** shall mean that Executive is (i) unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, or (ii) by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the Employer.

(f) **"Good Reason"** shall mean Executive's voluntary Termination of employment for one or more of the following reasons:

(i) an adverse change in the nature, scope or status of Executive's position, authorities or duties from those in effect in accordance with **Section 3** immediately following the Effective Date, or if applicable and greater, immediately prior to the Covered Period;

(ii) a reduction in Executive's Annual Base Salary, Incentive Bonus opportunity, or material reduction in Executive's aggregate compensation and benefits from that in effect immediately following the Effective Date, or if applicable and greater, immediately prior to the Covered Period;

(iii) relocation of Executive's primary place of employment of more than ninety (90) miles from Executive's primary place of employment immediately following the Effective Date, or if applicable, prior to the Covered Period, or a requirement that Executive engage in travel that is materially greater than was required prior to the Covered Period;

(iv) failure by an acquirer to assume this Agreement at the time of a Change of Control; or

(v) a material breach by the Employer, or its successor, of this Agreement.

Notwithstanding the foregoing, prior to Executive's Termination for Good Reason, Executive must give the Employer written notice of the existence of any condition set forth in clause (i) – (v) above within ninety (90) days of such initial existence and the Employer shall have thirty (30) days from the date of receipt of such notice in which to cure the condition giving rise to Good Reason, if curable. If, during such thirty (30) day period, the Employer cures the condition giving rise to Good Reason, no payments or benefits shall be due under **Section 6** of this Agreement with respect to such occurrence. If, during such thirty (30) day period, the Employer fails or refuses to cure the condition giving rise to Good Reason, Executive shall be entitled to payments or benefits under **Section 6** of this Agreement upon such Termination; *provided* such Termination occurs within 24 months after such initial existence of the applicable condition.

(g) "**Minimum Payments**" shall mean, as applicable, the following amounts:

(i) Executive's earned but unpaid Annual Base Salary for the period ending on the Termination Date;

(ii) Executive's earned but unpaid Incentive Bonus for the previously completed fiscal year;

(iii) Executive's accrued but unpaid vacation pay for the period ending on the Termination Date;

(iv) Executive's unreimbursed business expenses and all other items earned and owed to Executive through the Termination Date; and

(v) benefits, incentives and awards described in **Section 6(f)**

(h) "**Pro Rata Bonus**" means a payment equal to the Incentive Bonus that Executive would have earned for the year of termination, based upon actual results of the Employer and pro-rated on a per diem basis (by dividing the number of days employed during the applicable performance period by the total number of days in the applicable performance period).

(i) "**Release**" shall mean a general release and waiver substantially in the form attached hereto as **Exhibit A**.



(j) “**Severance Amount**” shall mean:

(i) for any Termination occurring during the Employment Period and not during a Covered Period, the benefit available under the Midland States Severance Plan; or

(ii) for any Termination occurring during a Covered Period, an amount equal to one hundred percent (100%) of Executive’s Base Compensation.

(k) “**Termination**” shall mean termination of Executive’s employment either:

(i) by the Employer or its successor, as the case may be, other than a Termination for Cause or any termination as a result of death or Disability; or

(ii) by Executive for Good Reason.

(l) “**Termination Date**” shall mean the date of employment termination, for any reason or no reason, indicated in the written notice provided by the Employer or Executive to the other.

(m) “**Termination for Cause**” shall mean only a termination by the Employer as a result of:

(i) Executive’s willful and continuing failure, that is not remedied within twenty (20) days after receipt of written notice of such failure from the CEO, to perform her obligations hereunder;

(ii) Executive’s willful act or acts of misconduct that are, alone or in the aggregate, materially and demonstrably injurious, monetarily or otherwise, to the Employer or an Affiliate, as determined in the sole discretion of the CEO; or

(iii) Executive’s breach of fiduciary responsibility or any obligation of Executive pursuant to **Section 8**.

(n) “**Voting Securities**” shall mean any securities which ordinarily possess the power to vote in the election of directors without the happening of any pre-condition or contingency.

**6. Rights and Payments Upon Termination.** Either party may terminate Executive’s employment under this Agreement pursuant to the terms and conditions of this **Section 6**. Subject to **Section 7** below, Executive’s right to benefits and payments, if any, for periods after the Termination Date shall be determined in accordance with this **Section 6**:

(a) **Minimum Payments.** If the Termination Date occurs during the Employment Period for any reason, Executive shall be entitled to the Minimum Payments, in addition to any payments or benefits to which Executive may be entitled under the following provisions of this **Section 6** (other than this **Section 6(a)**) or the express terms of any employee benefit plan or as required by law. Any payments to be made to Executive pursuant to this **Section 6(a)** shall be made within thirty (30) days after the Termination Date; provided that any benefits,

incentives or awards payable as described in **Section 6(f)** shall be made in accordance with the provisions of the applicable plan, program or arrangement. Except as may be otherwise expressly provided to the contrary in this Agreement or as otherwise provided by law, nothing in this Agreement shall be construed as requiring Executive to be treated as employed by the Employer following the Termination Date for purposes of any employee benefit plan or arrangement in which Executive may participate at such time.

**(b) Termination for Cause, Death, Disability, Voluntary Resignation and Non-Renewal.**

(i) Upon a determination of a Termination for Cause by the Employer, Executive's death or Disability, or Executive's voluntary resignation other than for Good Reason, Executive's employment shall immediately terminate.

(ii) If the Termination Date occurs during the Employment Period and is a result of a Termination for Cause, death, Disability, voluntary resignation other than for Good Reason or if this Agreement expires due to notice of non-renewal by either party as provided under **Section 2** or at the end of a Covered Period, then, other than the Minimum Payments, Executive shall have no right to payments or benefits under this Agreement (and the Employer shall have no obligation to make any such payments or provide any such benefits) for periods after the Termination Date.

**(c) Termination Other than for Cause or Termination for Good Reason.** If Executive's employment by the Employer, or any Affiliate or successor of the Employer, shall be subject to a Termination other than during a Covered Period, then, in addition to the Minimum Payments, the Employer shall provide Executive the following benefits:

(i) Commencing on the Termination Date, Executive shall receive the applicable Severance Amount (less any amount described in **subparagraph (ii)** below) paid in 12 substantially equal monthly installments, with each successive payment being due on the monthly anniversary of the Termination Date.

(ii) To the extent any portion of the applicable Severance Amount exceeds the "safe harbor" amount described in Treasury Regulation Section 1.409A-1(b)(9)(iii)(A), Executive shall receive such portion of the applicable Severance Amount that exceeds the "safe harbor" amount in a single lump sum payment payable within five (5) days after Executive's Termination Date.

(iii) Executive (and dependents, as may be applicable) shall be entitled to the medical benefits provided in **Section 6(e)** below.

**(d) Termination Upon a Change of Control.** If Executive's employment by the Employer, or any Affiliate or successor of the Employer, shall be subject to a Termination within a Covered Period, then, in addition to Minimum Payments, the Employer shall provide Executive the following benefits:

(i) Within five (5) days after Executive's Termination Date, the Employer shall pay Executive a lump sum payment in an amount equal to the Severance Amount.

(ii) Executive (and her dependents, as may be applicable) shall be entitled to the medical benefits provided in **Section 6(e)** below.

(iii) Executive shall be entitled to receive a Pro Rata Bonus, when Incentive Bonuses are paid to other senior management of Employer, consistent with **Section 4(b)** of this Agreement.

(e) **Medical, Dental and Life Insurance Benefits.** If Executive's employment by the Employer or any Affiliate or successor of the Employer shall be subject to a Termination as provided in **subsections (c) or (d)** above within the Employment Period, then to the extent that Executive or any of Executive's dependents may be covered under the terms of any medical and dental plans of the Employer (or any Affiliate) for active employees immediately prior to the termination, then, for as long as Executive is eligible for and elects coverage under the health care continuation rules of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("**COBRA**"), the Employer will provide Executive and those dependents with equivalent coverage, with Executive required to pay the same amount as Executive would pay if Executive continued in employment with the Employer or an Affiliate during such period, but in no event more than twelve (12) months following termination. The coverage may be procured directly by the Employer (or any Affiliate, if appropriate) apart from, and outside of the terms of the plans themselves; provided that Executive and Executive's dependents comply with all of the conditions of the medical or dental plans, with the cost to the Employer not to exceed the cost for continued COBRA coverage. In the event Executive or any of Executive's dependents become eligible for coverage under the terms of any other medical and/or dental plan of a subsequent employer which plan benefits are comparable to Employer (or any Affiliate) plan benefits, coverage under Employer (or any Affiliate) plans will cease for the eligible Executive and/or dependent. Executive and Executive's dependents must notify the Employer (or any Affiliate) of any subsequent employment and provide information regarding medical and/or dental coverage available. In the event the Employer (or any Affiliate) discovers that Executive and/or dependent has become employed and not provided the above notification, all payments and benefits under this subsection (e) will cease.

(f) **Other Benefits.** Executive's rights following a Termination with respect to any benefits, incentives or awards provided to Executive pursuant to the terms and conditions of any plan, program or arrangement sponsored or maintained by the Employer, whether tax-qualified or not, which are not specifically addressed herein, shall be subject to the terms and conditions of such plan, program or arrangement and this Agreement shall have no effect upon such terms and conditions except as specifically provided herein.

7. **Release.** Notwithstanding anything contained in this Agreement to the contrary, no payments or benefits (including without limitation, vesting of any and all stock options, shares of restricted stock, restricted stock units and other unvested incentive awards) payable to Executive under **Section 6(c), 6(d) or 6(e)** (except for payments and benefits described in **Section 6(a)**) shall be paid or provided to Executive unless he/she first executes (without subsequent revocation) and delivers to the Employer a Release. To the extent any of the payments and/or benefits due under **Section 6(c), 6(d) or 6(e)** are determined to be subject to Section 409A of the Internal Revenue Code of 1986, as amended (the "**Code**"), the Release must be executed and become irrevocable on or before the 60<sup>th</sup> day following the Termination Date. Provided that an executed, irrevocable

Release has been delivered on or before the 60<sup>th</sup> day following the Termination Date, any payments and benefits that are determined to be subject to Section 409A of the Code shall become payable, or shall otherwise commence, as of the 60<sup>th</sup> day following the Termination Date. If an executed, irrevocable Release is not delivered on or before the 60<sup>th</sup> day following the Termination Date, Executive shall forever forfeit any and all rights to any payment or benefit (to the extent such payment or benefit is determined to be subject to Section 409A of the Code) under **Section 6(c), 6(d) or 6(e)** or any payment or benefit in lieu thereof.

**8. Restrictive Covenants.**

**(a) Confidential Information.** Executive acknowledges that, during the course of her employment with the Employer, Executive may produce and have access to confidential and/or proprietary non-public information concerning the Employer and its Affiliates, including marketing materials, financial and other information concerning customers and prospective customers, customer lists, records, data, trade secrets, proprietary business information, pricing and profitability information and policies, strategic planning, commitments, plans, procedures, litigation, pending litigation and other information not generally available to the public (collectively, "**Confidential Information**"). Executive agrees not to directly or indirectly use, disclose, copy or make lists of Confidential Information for the benefit of anyone other than the Employer, either during or after her employment with the Employer, except to the extent that such information is or thereafter becomes lawfully available from public sources, or such disclosure is authorized in writing by the Employer, required by law or any competent administrative agency or judicial authority, or otherwise as reasonably necessary or appropriate in connection with performance by Executive of her duties hereunder. Executive agrees that, if she receives a subpoena or other court order or is otherwise required by law to provide information to a governmental authority or other person concerning the activities of the Employer or any of its Affiliates, or her activities in connection with the business of the Employer or any of its Affiliates, Executive will immediately notify the Employer of such subpoena, court order or other requirement and deliver forthwith to the Employer a copy thereof and any attachments and non-privileged correspondence related thereto. Executive shall take reasonable precautions to protect against the inadvertent disclosure of Confidential Information. Executive agrees to abide by the Employer's reasonable policies, as in effect from time to time, respecting avoidance of interests conflicting with those of the Employer and its Affiliates. In this regard, Executive shall not directly or indirectly render services to any person or entity where Executive's service would involve the use or disclosure of Confidential Information. Executive agrees not to use any Confidential Information to guide her in searching publications or other publicly available information, selecting a series of items of knowledge from unconnected sources and fitting them together to claim that he/she did not violate any agreements set forth in this Agreement.

**(b) Documents and Property.** All records, files, documents and other materials or copies thereof relating to the business of the Employer and its Affiliates, which Executive shall prepare, receive, or use, shall be and remain the sole property of the Employer and, other than in connection with performance by Executive of his duties hereunder, shall not be removed from the premises of the Employer or any of its Affiliates without the Employer's prior written consent, and shall be promptly returned to the Employer upon Executive's termination of employment together with all copies (including copies or recordings in electronic form), abstracts,

notes or reproductions of any kind made from or about the records, files, documents or other materials.

(c) **Non-Competition and Non-Solicitation.** The Employer and Executive have agreed that the primary service area of the Employer's lending and deposit taking functions in which Executive will actively participate extends separately to an area that encompasses a twenty-five (25) mile radius from each banking or other office location of the Employer and its Affiliates (collectively, the "**Restricted Area**"). Therefore, as an essential ingredient of and in consideration of this Agreement and her employment by the Employer, Executive agrees that, during her employment with the Employer and for a period of twelve (12) months immediately following the termination of his employment (the "**Restricted Period**"), for whatever reason, where such termination occurs during the Employment Period or thereafter, he/she will not, except with the express prior written consent of the Employer, directly or indirectly, do any of the following (all of which are collectively referred to in this agreement as the "**Restrictive Covenant**"):

(i) Engage or invest in, own, manage, operate, finance, control, or participate in the ownership, management, operation or control of, be employed by, associated with, or in any manner connected with, serve as a director, officer or consultant to, lend her name or any similar name to, lend her credit to, or render services or advice to, any person, firm, partnership, corporation or trust which owns, operates or is in the process of forming, a bank, savings and loan association, credit union or similar financial institution (a "**Financial Institution**") with an office located, or to be located at an address identified in a filing with any regulatory authority, within the Restricted Area; *provided however*, that the ownership by Executive of shares of the capital stock of any Financial Institution which shares are listed on a securities exchange or quoted on the National Association of Securities Dealers Automated Quotation System and which do not represent more than five percent (5%) of the institution's outstanding capital stock, shall not violate any terms of this Agreement.

(ii) Executive will not, directly or indirectly, either for himself/herself, or any Financial Institution: (1) induce or attempt to induce any employee of the Employer or any of its Affiliates to leave the employ of the Employer or any of its Affiliates; (2) in any way interfere with the relationship between the Employer or any of its Affiliates and any employee of the Employer or any of its Affiliates; or (3) induce or attempt to induce any customer, supplier, licensee, or business relation of the Employer or any of its Affiliates to cease doing business with the Employer or any of its Affiliates or in any way interfere with the relationship between the Employer or any of its Affiliates and their respective customers, suppliers, licensees or business relations.

(iii) Executive will not, directly or indirectly, either for himself/herself, or any Financial Institution, solicit the business of any person or entity known to Executive to be a customer of the Employer or any of its Affiliates, where Executive, or any person reporting to Executive, had personal contact with such person or entity, with respect to products, activities or services which compete in whole or in part with the products, activities or services of the Employer or any of its Affiliates.

(iv) Executive will not, directly or indirectly, serve as the agent, broker or representative of, or otherwise assist, any person or entity in obtaining services or products from any Financial Institution within the Restricted Area, with respect to the products, activities or services which compete in whole or in part with the products, activities or services of the Employer or any of its Affiliates.

**(d) Work for Hire Provisions.**

(i) **Exclusive Rights of the Employer in Work Product.** The parties acknowledge and agree that all work performed by Executive for the Employer or any of its Affiliates shall be deemed “work for hire.” The Employer shall at all times own and have exclusive right, title and interest in and to all Confidential Information and Inventions (as defined below), and the Employer shall retain the exclusive right to license, sell, transfer and otherwise use and dispose of the same. Any and all enhancements of the technology of the Employer or any of its Affiliates that are developed by Executive shall be the exclusive property of the Employer. Executive hereby assigns to the Employer any right, title and interest in and to all Inventions that he/she may have, by law or equity, without additional consideration of any kind whatsoever from the Employer or any of its Affiliates. Executive agrees to execute and deliver any instruments or documents and to do all other things (including the giving of testimony) requested by the Employer (both during and after the termination of her employment with the Employer) in order to vest more fully in the Employer or any of its Affiliates all ownership rights in the Inventions (including obtaining patent, copyright or trademark protection therefore in the United States and/or foreign countries).

(ii) **Definitions and Exclusions.** For purposes of this Agreement, “**Inventions**” means all systems, procedures, techniques, manuals, data bases, plans, lists, inventions, trade secrets, copyrights, patents, trademarks, discoveries, innovations, concepts, ideas and software conceived, compiled or developed by Executive in the course of her employment with the Employer or any of its Affiliates and/or comprised, in whole or part, of Confidential Information. Notwithstanding the foregoing, Inventions shall not include: (i) any inventions independently developed by Executive and not derived, in whole or part, from any Confidential Information or (ii) any invention made by Executive prior to her exposure to any Confidential Information.

(e) **Remedies for Breach of Restrictive Covenants.** Executive has reviewed the provisions of this Agreement with legal counsel, or has been given adequate opportunity to seek such counsel, and Executive acknowledges and expressly agrees that the covenants contained in this **Section 8** are reasonable with respect to their duration, geographical area and scope. Executive further acknowledges that the restrictions contained in this **Section 8** are reasonable and necessary for the protection of the legitimate business interests of the Employer, that they create no undue hardships, that any violation of these restrictions would cause substantial injury to the Employer and such interests, and that such restrictions were a material inducement to the Employer to enter into this Agreement. In the event of any violation or threatened violation of these restrictions, the Employer, in addition to and not in limitation of, any other rights, remedies or damages available to the Employer under this Agreement or otherwise at law or in equity, shall be entitled to preliminary and permanent injunctive relief to prevent or restrain any such violation by Executive and any and all persons directly or indirectly acting for or with her, as the case may be.

(f) In the event of the existence of any other agreement between the parties which (i) is in effect during the Restricted Period, and (ii) which contains restrictive covenants that conflict with any of the provisions of this **Section 8**, then the more restrictive of such provisions from the agreements shall control for the period during which the agreements would otherwise be in effect.

**9. No Set-Off; No Mitigation.** Except as provided herein, the Employer's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including any set-off, counterclaim, recoupment, defense or other right which the Employer may have against Executive or others. In no event shall Executive be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to Executive under any of the provisions of this Agreement, and such amounts shall not be reduced whether or not Executive obtains other employment.

**10. Notices.** Notices and all other communications under this Agreement shall be in writing and shall be deemed given when mailed by United States registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to the Employer (with a copy to the Company):

Midland States Bank  
Attention: Chief Executive Officer and Corporate Counsel  
1201 Network Centre Drive

Effingham, Illinois 62401

If to Executive, to such home address or other address as Executive has most recently provided to the Employer.

or to such other address as either party may furnish to the other in writing, except that notices of changes of address shall be effective only upon receipt.

**11. Applicable Law.** All questions concerning the construction, validity and interpretation of this Agreement and the performance of the obligations imposed by this Agreement shall be governed by the internal laws of the State of Illinois applicable to agreements made and wholly to be performed in such state without regard to conflicts of law provisions of any jurisdiction, and any court action commenced to enforce this Agreement shall have as its sole and exclusive venue the County of Effingham, Illinois.

**12. Entire Agreement; Survival.**

(a) This Agreement constitutes the entire agreement between Executive and the Employer concerning the subject matter hereof, and supersedes all prior negotiations, undertakings, agreements and arrangements with respect thereto, whether written or oral, specifically including the Prior Agreement. If a court of competent jurisdiction determines that any provision of this Agreement is invalid or unenforceable, then the invalidity or unenforceability of that provision shall not affect the validity or enforceability of any other provision of this Agreement and all other provisions shall remain in full force and effect. The various covenants and provisions of this Agreement are intended to be severable and to constitute independent and

distinct binding obligations. Without limiting the generality of the foregoing, if the scope of any covenant contained in this Agreement is too broad to permit enforcement to its full extent, such covenant shall be enforced to the maximum extent permitted by law, and Executive hereby agrees that such scope may be judicially modified accordingly.

(b) The provisions of **Section 8** shall survive the termination of this Agreement.

**13. Withholding of Taxes.** The Employer may withhold from any benefits payable under this Agreement all federal, state, city or other taxes as may be required pursuant to any law, governmental regulation or ruling.

**14. No Assignment.** Executive's rights to receive payments or benefits under this Agreement shall not be assignable or transferable whether by pledge, creation of a security interest or otherwise, other than a transfer by will or by the laws of descent or distribution. In the event of any attempted assignment or transfer contrary to this Section, the Employer shall have no liability to pay any amount so attempted to be assigned or transferred. This Agreement shall inure to the benefit of and be enforceable by Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees.

**15. Successors.** This Agreement shall be binding upon and inure to the benefit of the Employer, its successors and assigns (including, without limitation, any company into or with which the Employer may merge or consolidate). The Employer agrees that it will not affect the sale or other disposition of all or substantially all of its assets (where such transaction would constitute a Change in Control) unless either (a) the person or entity acquiring the assets, or a substantial portion of the assets, shall expressly assume by an instrument in writing all duties and obligations of the Employer under this Agreement, or (b) the Employer shall provide, through the establishment of a separate reserve, for the payment in full of all amounts which are or may reasonably be expected to become payable to Executive under this Agreement.

**16. Legal Fees.** In the event that either party commences arbitration or litigation to enforce or protect her and/or its rights under this Agreement, the prevailing party in any such action shall be entitled to recover reasonable attorneys' fees and costs (including the costs of experts, evidence and counsel) relating to such action, in addition to all other entitled relief, including but not limited to damages and injunctive relief.

**17. Amendment.** This Agreement may not be amended or modified except by written agreement signed by Executive and the Employer.

**18. Internal Revenue Code Section 409A.**

(a) It is intended that this Agreement comply with the provisions of Section 409A of the Code so as not to subject Executive to the payment of additional taxes and interest under Section 409A of the Code. In furtherance of this intent, this Agreement shall be interpreted, operated and administered in a manner consistent with these intentions, and to the extent that any regulations or other guidance issued under Section 409A of the Code would result in Executive being subject to payment of additional income taxes or interest under Section 409A of the Code, the parties agree to amend this Agreement to maintain to the maximum extent practicable the



original intent of the Agreement while avoiding the application of such taxes or interest under Section 409A of the Code.

(b) Notwithstanding any provision in this Agreement to the contrary, if Executive is determined to be a Specified Employee as of the Termination Date, then, to the extent required pursuant to Section 409A(a)(2)(B)(i) of the Code, payments due under this Agreement which are deemed to be deferred compensation shall be subject to a six (6) month delay following the Termination Date. For purposes of Section 409A of the Code, all installment payments of deferred compensation made hereunder, or pursuant to another plan or arrangement, shall be deemed to be separate payments and, accordingly, the aforementioned deferral shall only apply to separate payments which would occur during the six (6) month deferral period and all other payments shall be unaffected. All delayed payments shall be accumulated and paid in a lump-sum catch-up payment as of the first day of the seventh-month following the Termination Date (or, if earlier, the date of death of Executive) with all such delayed payments being credited with interest (compounded monthly) for this period of delay equal to the prime rate in effect on the first day of such six-month period. Any portion of the benefits hereunder that were not otherwise due to be paid during the six-month period following the Termination Date shall be paid to Executive in accordance with the payment schedule established herein.

(c) The term “**Specified Employee**” shall mean any person who is a “key employee” (as defined in Code Section 416(i) of the Code without regard to paragraph (5) thereof), as determined by the Employer based upon the 12-month period ending on each December 31st (such 12-month period is referred to below as the “identification period”). If Executive is determined to be a key employee under Section 416(i) of the Code (without regard to paragraph (5) thereof), he/she shall be treated as a Specified Employee for purposes of this Agreement during the 12-month period that begins on the April 1 following the close of such identification period. For purposes of determining whether Executive is a key employee under Section 416(i) of the Code, “compensation” shall mean Executive’s W-2 compensation as reported by the Employer for a particular calendar year.

*(remainder of page intentionally left blank)*

IN WITNESS WHEREOF, the parties have executed this Agreement as of the Effective Date.

**MIDLAND STATES BANK**

**JEFFREY MEFFORD**

By: /s/ Leon J. Holschbach  
Name: Leon J. Holschbach  
Its: President & Chief Executive Officer

/s/ Jeffrey Mefford  
[Signature]

## AMENDMENT NO. 1 TO EMPLOYMENT AGREEMENT

**THIS AMENDMENT NO. 1 TO EMPLOYMENT AGREEMENT** (this “**Amendment**”) is made and entered into as of December 15, 2017 (the “**Effective Date**”) by and between Midland States Bank, an Illinois banking corporation (the “**Bank**”, hereinafter referred to as the “**Employer**”), and Jeffrey S. Mefford (“**Executive**”).

## RECITALS

- A. The Executive is currently employed as Executive Vice President, Banking, of the Bank and has entered into an Employment Agreement with the Bank, dated as of December 1, 2010 (the “**Employment Agreement**”).
- B. The Chief Executive Officer of the Bank has recommended, and the Midland States Bancorp, Inc. (the “**Company**”) Compensation Committee has approved, changes to the target Incentive Bonus and long-term incentive bonus percentages for the Executive.
- C. Since the date of the Employment Agreement the SEC has requested that all issuer’s subject to the reporting requirements of Securities Exchange Act of 1934 include a provision in the issuer’s employment agreements with respect certain rights of the employee to contact the SEC and other government agencies with respect to possible violations of the federal securities laws.

## AGREEMENTS

- 1. The reference in Section 4(b) of the Employment Agreement to a target Incentive Bonus is hereby amended to “not less than forty percent (40%)”; and a new sentence shall be added as follows: “The long-term incentive bonus percentage for the Executive shall be forty-five percent (45%).”
- 2. A new Section 8(g) is hereby added to the Employment Agreement as follows:
  - (g) Nothing contained herein shall impede Executive’s ability to communicate with the staff of the Securities and Exchange Commission or other governmental agencies regarding possible federal securities law violations (i) without the Company’s prior approval, and (ii) without having to forfeit or forgo any resulting whistleblower awards.”

In all other respects the Employment Agreement shall remain fully in force and effect.

**IN WITNESS WHEREOF**, the parties have executed this Amendment as of the Effective Date.

**MIDLAND STATES BANK**

**JEFFREY MEFFORD**

By: /s/ Leon J. Holschbach  
 Name: Leon J. Holschbach  
 Its: Chief Executive Officer

/s/ Jeffrey Mefford  
 [Signature]

## AMENDMENT NO. 2 TO EMPLOYMENT AGREEMENT

**THIS AMENDMENT NO. 2 TO EMPLOYMENT AGREEMENT** (this “**Amendment**”) is made and entered into as of January 1, 2019 (the “**Effective Date**”) by and between Midland States Bank, an Illinois banking corporation (the “**Bank**”, hereinafter referred to as the “**Employer**”), and Jeffrey S. Mefford (“**Executive**”).

## RECITALS

- A. Executive serves as President of the Bank, and has entered into an Employment Agreement with the Company and the Bank, dated as of December 1, 2010, as amended by that certain Amendment No. 1 to Employment Agreement dated as of December 15, 2017 (the “**Employment Agreement**”).
- B. The Compensation Committee of Midland States Bancorp, Inc. (the “**Company**”) has approved increases to the Executive’s target Incentive Bonus and long-term incentive bonus percentages and instructed that an amendment to Executive’s Employment Agreement be executed reflecting such increases.

## AGREEMENTS

Now therefore, the Employment Agreement is hereby amended as follows:

**1.** The reference in Section 4(b) of the Employment Agreement to a target Incentive Bonus is hereby amended to “not less than sixty percent (60%)”; and the reference to a long-term incentive bonus percentage for the Executive is hereby amended to “fifty-five percent (55%).”

In all other respects the Employment Agreement shall remain fully in force and effect.

**IN WITNESS WHEREOF**, the parties have executed this Amendment as of the Effective Date.

**MIDLAND STATES BANK**

**JEFFREY S. MEFFORD**

By:       /s/       Leon J. Holschbach

/s/ Jeffrey S.

Mefford

Name: Leon J. Holschbach

[Signature]

Its: Vice-Chairman

## Employment Agreement

**This Employment Agreement** (this “**Agreement**”) is made and entered into as of February 20, 2017 (the “**Effective Date**”) by and between Midland States Bank, an Illinois banking corporation (the “**Employer**”) and James Stewart (the “**Executive**”).

### Recitals

**A.** The Executive is currently employed as Senior Vice President, Chief Risk Officer of the Employer pursuant to the terms and conditions of that certain employment agreement by and between the parties dated May 14, 2012 (the “**Prior Agreement**”).

**B.** Employer and Executive now wish to enter into this Agreement to replace in its entirety the Prior Agreement.

**Now, therefore,** in consideration of the premises and of the covenants and agreements hereinafter contained, it is covenanted and agreed by and between the parties hereto as follows:

### Agreements

**1. Prior Agreement.** As of the Effective Date, the Agreement shall supersede and replace any and all prior agreements respecting Executive’s employment by, or service to, the Employer of the Company as may from time to time have been made by and between the parties, whether or not in writing, including but not limited to the Prior Agreement; *provided however*, that any vested benefits due to Executive pursuant to any pension plan, welfare benefit plan or any other employee benefit plan shall continue to be available to Executive subject to the terms and conditions of the applicable plan as may be in effect from time to time.

**2. Employment Period.** Subject to the terms and conditions of this Agreement, the Employer hereby agrees to employ Executive during the Employment Period and Executive hereby agrees to continue to remain in the employ of the Employer and to provide services during the Employment Period in accordance with this Agreement. The “**Employment Period**” shall be the period commencing on the Effective Date and ending December 31, 2017, unless sooner terminated as provided herein. This agreement shall automatically renew for additional one year terms from January 1<sup>st</sup> to December 31<sup>st</sup> of each year unless either the Employer or the Executive notifies the other party, by written notice delivered no later than 90 days prior to December 31<sup>st</sup> of each year that the “**Employment Period**” shall not be extended for an additional year. Notwithstanding anything contained herein to the contrary, if a Change of Control occurs during the Employment Period, this Agreement shall remain in effect for one (1) year period following the Change of Control and shall then terminate.

**3. Duties.** Executive agrees that during the Employment Period, Executive will devote his full business time, energies and talents to serving as the President and CEO of the Employer, at the direction of the Company’s Chief Executive Officer (“**CEO**”). Executive shall have such duties and responsibilities as may be assigned to Executive from time to time by the CEO, which duties and responsibilities shall be commensurate with Executive’s position, shall perform all duties assigned to Executive faithfully and efficiently, subject to the direction of the

CEO, and shall have such authorities and powers as are inherent to the undertakings applicable to Executive's position and necessary to carry out the responsibilities and duties required of Executive hereunder. Executive will perform the duties required by this Agreement at the Company's principal place of business unless the nature of such duties requires otherwise. Notwithstanding the foregoing, during the Employment Period, Executive may devote reasonable time to activities other than those required under this Agreement, including activities of a charitable, educational, religious or similar nature (including professional associations) to the extent such activities do not, in the reasonable judgment of the CEO, inhibit, prohibit, interfere with or conflict with Executive's duties under this Agreement or conflict in any material way with the business of the Employer and its Affiliates; *provided, however*, that Executive shall not serve on the board of directors of any business (other than the Employer or its Affiliates) or hold any other position with any business without receiving the prior written consent of the CEO.

**4. Compensation and Benefits.** Subject to the terms and conditions of this Agreement, during the Employment Period, while Executive is employed by the Employer, the Employer shall compensate Executive for Executive's services as follows for periods following the Effective Date:

(a) Executive shall be compensated at an annual rate of \$266,000 (the "**Annual Base Salary**"), which shall be payable and adjusted in accordance with the Employer's normal payroll practices as are in effect from time to time. Executive shall be entitled to receive performance based annual incentive bonuses (each, the "**Incentive Bonus**") from the Employer for each fiscal year ending during the Employment Period. Any such Incentive Bonus shall be paid to Executive within thirty (30) days of the completion of the annual audit by the Employer's auditor, but in no event later than two and one-half months after the close of each such fiscal year. Executive's target Incentive Bonus shall be not less than thirty five percent (35%) of the Annual Base Salary, which Incentive Bonus shall be determined by specific performance criteria established from time to time by the CEO.

(b) Executive shall be eligible to participate, subject to the terms and conditions thereof, in all other incentive plans and programs, including such cash and deferred bonus programs and equity incentive plans as may be in effect from time to time with respect to senior executives employed by the Employer. Executive and Executive's dependents, as the case may be, shall be eligible to participate in all pension and similar benefit plans (qualified, non-qualified and supplemental), profit sharing, 401(k), as well as all medical and dental, disability, group and executive life, accidental death and travel accident insurance, and other similar welfare benefit plans and programs of the Employer, subject to the terms and conditions thereof, as in effect from time to time with respect to senior executives employed by the Employer. With respect to group life insurance, Executive's coverage amount shall be equal to one times salary with a minimum of \$50,000 and a maximum of \$300,000.

(c) Executive shall be entitled to accrue vacation at a rate of four (4) weeks paid vacation for each calendar year, subject to the Employer's vacation programs and policies as may be in effect during the Employment Period.

(d) Executive shall be reimbursed by the Employer, on terms and conditions that are substantially similar to those that apply to other similarly situated executives of the

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Employer, for reasonable out-of-pocket expenses for entertainment, travel, meals, lodging and similar items which are consistent with the Employer's expense reimbursement policy and actually incurred by Executive in the promotion of the Employer's business.

5. **Definitions.** As used throughout this Agreement, all of the terms defined in this Section 5 shall have the meanings given below.

(a) **"Affiliate"** shall mean each company, corporation, partnership, bank, savings bank, savings and loan association, credit union or other financial institution, directly or indirectly, which is controlled by, controls, or is under common control with, the Company, where "control" means (x) the ownership of 51% or more of the voting securities or other voting interest or other equity interest of any corporation, partnership, joint venture or other business entity, or (y) the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such corporation, partnership, joint venture or other business entity.

(b) **"Base Compensation"** shall mean the amount of equal to the sum of (i) the greater of Executive's then-current Annual Base Salary or Executive's Annual Base Salary as of the date one (1) day prior to the Change of Control; and (ii) the average of the Incentive Bonus paid (or payable) for the three (3) most recently completed fiscal years of the Company.

(c) **"Change of Control"** shall mean the first to occur of the following:

(i) Any Person, other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company or a corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the beneficial owner (within the meaning of Rule 13d-3 of the Exchange Act), directly or indirectly, of securities representing fifty percent (50%) or more of the total voting power represented by the Company's then outstanding Voting Securities; or

(ii) During any period of twelve (12) consecutive months, individuals who at the beginning of such period constitute the Board of Directors of the Company and any new Director whose election by the Board of Directors or nomination for election by the Company's stockholders was approved by a vote of at least two-thirds (2/3) of the Directors then still in office who either were Directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof; or

(iii) Consummation of: (i) a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into Voting Securities of the surviving entity) at least fifty percent (50%) of the total voting power represented by the Voting Securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; or (ii) a complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all the Company's assets.

However, in no event shall a Change in Control be deemed to have occurred, with respect to the Executive if the Executive is part of a purchasing group which consummates the Change-in-Control transaction. The Executive shall be deemed "part of a purchasing group" for purposes of

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the preceding sentence if the Executive is an equity participant in the purchase company or group (except for (i) passive ownership of less than two percent (2%) of the stock of the purchasing company; or (ii) ownership of equity participation in the purchasing company or group which is otherwise not significant, as determined prior to the Change in Control by a majority of the non-employee continuing Directors).

In the event that any benefit under this Agreement constitutes deferred compensation, and the settlement of, or distribution of such benefits is to be triggered by a Change in Control, then such settlement or distribution shall be subject to the event constituting the Change in Control also constituting a “change in the ownership” or “change in the effective control” of the Company, as permitted under Code Section 409A.

(d) “**Covered Period**” shall mean the period beginning six (6) months prior to a Change of Control and ending twelve (12) months after the Change of Control.

(e) “**Disability**” shall mean that Executive is (i) unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, or (ii) by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the Employer.

(f) “**Good Reason**” shall mean Executive’s voluntary Termination of employment for one or more of the following reasons:

(i) a materially adverse change in the nature, scope or status of Executive’s position, authorities or duties from those in effect in accordance with **Section 3** immediately following the Effective Date, or if applicable and greater, immediately prior to the Covered Period;

(ii) a material reduction in Executive’s Annual Base Salary or Target Incentive Bonus opportunity from that in effect immediately following the Effective Date, or if applicable and greater, immediately prior to the Covered Period (in each case excluding a reduction principally resulting from Executive’s actual Incentive Bonus);

(iii) relocation of Executive’s primary place of employment of more than ninety (90) miles from Executive’s primary place of employment immediately following the Effective Date, or if applicable, prior to the Covered Period, or a requirement that Executive engage in travel that is materially greater than was required prior to the Covered Period;

(iv) failure by an acquirer to assume this Agreement at the time of a Change of Control; or

(v) a material breach by the Employer, or its successor, of this Agreement.

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Notwithstanding the foregoing, prior to Executive's Termination for Good Reason, Executive must give the Employer written notice of the existence of any condition set forth in clause (i) – (v) above within thirty (30) days of such initial existence and the Employer shall have thirty (30) days from the date of receipt of such notice in which to cure the condition giving rise to Good Reason, if curable, or at the option of the Company, to treat Executive's written notice as a resignation and accept such resignation. If, during such thirty (30) day period, the Employer cures the condition giving rise to Good Reason, no payments or benefits shall be due under **Section 6** of this Agreement with respect to such occurrence. If, during such thirty (30) day period, the Employer fails or refuses to cure the condition giving rise to Good Reason, Executive shall be entitled to payments or benefits under **Section 6** of this Agreement upon such Termination; *provided* such Termination occurs within 30 days after the end of such cure period.

(g) “**Minimum Payments**” shall mean, as applicable, the following amounts:

(i) Executive's earned but unpaid Annual Base Salary for the period ending on the Termination Date;

(ii) Executive's earned but unpaid Incentive Bonus for the previously completed fiscal year;

(iii) Executive's accrued but unpaid vacation pay for the period ending on the Termination Date;

(iv) Executive's unreimbursed business expenses and all other items earned and owed to Executive through the Termination Date; and

(v) benefits, incentives and awards described in **Section 6(f)**

(h) “**Pro Rata Bonus**” means a payment equal to the Incentive Bonus that Executive would have earned for the year of termination, based upon actual results of the Employer and pro-rated on a per diem basis (by dividing the number of days employed during the applicable performance period by the total number of days in the applicable performance period).

(i) “**Release**” shall mean a general release and waiver substantially in the form attached hereto as **Exhibit A**.

(j) “**Severance Amount**” shall mean:

(i) for any Termination occurring during the Employment Period and not during a Covered Period, the benefit available under the Company's Severance Plan or Policy as is effect from time to time; or

(ii) for any Termination occurring during a Covered Period, an amount equal to one hundred percent (100%) of Executive's Base Compensation.

(k) “**Termination**” shall mean termination of Executive's employment either:

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(i) by the Employer or its successor, as the case may be, other than (1) a Termination for Cause or (2) any termination as a result of death or Disability; or

(ii) by Executive for Good Reason.

**(l)** “**Termination Date**” shall mean the date of employment termination, for any reason or no reason, indicated in the written notice provided by the Employer or Executive to the other.

**(m)** “**Termination for Cause**” shall mean only a termination by the Employer as a result of:

(i) Executive’s willful failure, that is not remedied within twenty (20) days after receipt of written notice of such failure from the Company, to perform his obligations hereunder;

(ii) Executive’s willful act or acts of misconduct that are, alone or in the aggregate, demonstrably injurious, monetarily or otherwise, to the Employer or an Affiliate, and/or a violation of Company policy /Regulatory Requirements as determined in the discretion of the Company; or

(iii) Executive’s breach of fiduciary responsibility or any obligation of Executive pursuant to **Section 6**.

**(n)** “**Voting Securities**” shall mean any securities which ordinarily possess the power to vote in the election of directors without the happening of any pre-condition or contingency.

**6. Rights and Payments Upon Termination.** Either party may terminate Executive’s employment under this Agreement pursuant to the terms and conditions of this **Section 6**. Subject to **Section 7** below, Executive’s right to benefits and payments, if any, for periods after the Termination Date shall be determined in accordance with this **Section 6**:

**(a) Minimum Payments.** If the Termination Date occurs during the Employment Period for any reason, Executive shall be entitled to the Minimum Payments, in addition to any payments or benefits to which Executive may be entitled under the following provisions of this **Section 5** (other than this **Section 5(a)**) or the express terms of any employee benefit plan or as required by law. Any payments to be made to Executive pursuant to this **Section 5(a)** shall be made within thirty (30) days after the Termination Date; provided that any benefits, incentives or awards payable as described in **Section 6(f)** shall be made in accordance with the provisions of the applicable plan, program or arrangement. Except as may be otherwise expressly provided to the contrary in this Agreement or as otherwise provided by law, nothing in this Agreement shall be construed as requiring Executive to be treated as employed by the Employer following the Termination Date for purposes of any employee benefit plan or arrangement in which Executive may participate at such time.

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**(b) Termination for Cause, Death, Disability, Voluntary Resignation and Non-Renewal.**

(i) Upon a determination of a Termination for Cause by the Employer, Executive's death or Disability, or Executive's voluntary resignation other than for Good Reason, Executive's employment shall immediately terminate.

(ii) If the Termination Date occurs during the Employment Period and is a result of a Termination for Cause, death, Disability, voluntary resignation other than for Good Reason or if this Agreement expires due to notice of non-renewal by either party as provided under **Section 1** or at the end of a Covered Period, then, other than the Minimum Payments, Executive shall have no right to payments or benefits under this Agreement (and the Employer shall have no obligation to make any such payments or provide any such benefits) for periods after the Termination Date.

**(c) Termination by the Company Other than for Cause; or Resignation by Executive for Good Reason.** If Executive's employment by the Employer, or any Affiliate or successor of the Employer, shall be subject to a Termination other than during a Covered Period, then, in addition to the Minimum Payments, the Employer shall provide Executive the following benefits:

(i) Commencing on the Termination Date, Executive shall receive the applicable Severance Amount (less any amount described in the next sentence) paid in accordance with the Company's regular payroll schedule. To the extent any portion of the applicable Severance Amount exceeds the "safe harbor" amount described in Treasury Regulation Section 1.409A-1(b)(9)(iii)(A), Executive shall receive such portion of the applicable Severance Amount that exceeds the "safe harbor" amount in a single lump sum payment payable within five (5) days after Executive's Termination Date.

**(d) Termination Upon a Change of Control.** If Executive's employment by the Employer, or any Affiliate or successor of the Employer, shall be subject to a Termination within a Covered Period, then, in addition to Minimum Payments, the Employer shall provide Executive the following benefits:

(i) Within five (5) days after Executive's Termination Date, the Employer shall pay Executive a lump sum payment in an amount equal to the Severance Amount.

(ii) Executive (and his dependents, as may be applicable) shall be entitled to the medical benefits provided in **Section 6(e)** below.

(iii) Executive shall be entitled to receive a Pro Rata Bonus, when Incentive Bonuses are paid to other senior management of Employer, consistent with **Section 4(a)** of this Agreement.

**(e) Medical and Dental Benefits.** If Executive's employment by the Employer or any Affiliate or successor of the Employer shall be subject to a Termination as provided in **subsections (c) or (d)** above within the Employment Period, then to the extent that Executive or any of Executive's dependents may be covered under the terms of any medical and

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dental plans of the Employer (or any Affiliate) for active employees immediately prior to the termination, then, for as long as Executive is eligible for and elects coverage under the health care continuation rules of the Consolidated Omnibus Budget Reconciliation Act of 1985 (“**COBRA**”), the Employer will provide Executive and those dependents with equivalent coverage, with Executive required to pay the same amount as Executive would pay if Executive continued in employment with the Employer or an Affiliate during such period, but in no event more than twelve (12) months following termination. The coverage may be procured directly by the Employer (or any Affiliate, if appropriate) apart from, and outside of the terms of the plans themselves; provided that Executive and Executive’s dependents comply with all of the conditions of the medical or dental plans, with the cost to the Employer not to exceed the cost for continued COBRA coverage. In the event Executive or any of Executive’s dependents become eligible for coverage under the terms of any other medical and/or dental plan of a subsequent employer which plan benefits are comparable to Employer (or any Affiliate) plan benefits, coverage under Employer (or any Affiliate) plans will cease for the eligible Executive and/or dependent. Executive and Executive’s dependents must notify the Employer (or any Affiliate) of any subsequent employment and provide information regarding medical and/or dental coverage available. In the event the Employer (or any Affiliate) discovers that Executive and/or dependent has become employed and not provided the above notification, all payments and benefits under this subsection (e) will cease.

(f) **Other Benefits.** Executive’s rights following a Termination with respect to any benefits, incentives or awards provided to Executive pursuant to the terms and conditions of any plan, program or arrangement sponsored or maintained by the Employer, whether tax-qualified or not, which are not specifically addressed herein, shall be subject to the terms and conditions of such plan, program or arrangement and this Agreement shall have no effect upon such terms and conditions except as specifically provided herein.

7. **Release.** Notwithstanding anything contained in this Agreement to the contrary, no payments or benefits (including without limitation, vesting of any and all stock options, shares of restricted stock, restricted stock units and other unvested incentive awards) payable to Executive under **Section 6, 6(d) or 6(e)** (except for payments and benefits described in **Section 6(a)**) shall be paid or provided to Executive unless he/she first executes (without subsequent revocation) and delivers to the Employer a Release. To the extent any of the payments and/or benefits due under **Section 6(c), 6(d) or 6(e)** are determined to be subject to Section 409A of the Internal Revenue Code of 1986, as amended (the “**Code**”), the Release must be executed and become irrevocable on or before the 60<sup>th</sup> day following the Termination Date. Provided that an executed, irrevocable Release has been delivered on or before the 60<sup>th</sup> day following the Termination Date, any payments and benefits that are determined to be subject to Section 409A of the Code shall become payable, or shall otherwise commence, as of the 60<sup>th</sup> day following the Termination Date. If an executed, irrevocable Release is not delivered on or before the 60<sup>th</sup> day following the Termination Date, Executive shall forever forfeit any and all rights to any payment or benefit (to the extent such payment or benefit is determined to be subject to Section 409A of the Code) under **Section 6(c), 6(d) or 6(e)** or any payment or benefit in lieu thereof.

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## 8. Restrictive Covenants.

(a) **Confidential Information.** Executive acknowledges that, during the course of his employment with the Employer, Executive may produce and have access to confidential and/or proprietary non-public information concerning the Employer and its Affiliates, including marketing materials, financial and other information concerning customers and prospective customers, customer lists, records, data, trade secrets, proprietary business information, pricing and profitability information and policies, strategic planning, commitments, plans, procedures, litigation, pending litigation and other information not generally available to the public (collectively, “**Confidential Information**”). Executive agrees not to directly or indirectly use, disclose, copy or make lists of Confidential Information for the benefit of anyone other than the Employer, either during or after his employment with the Employer, except to the extent that such information is or thereafter becomes lawfully available from public sources, or such disclosure is authorized in writing by the Employer, required by law or any competent administrative agency or judicial authority, or otherwise as reasonably necessary or appropriate in connection with performance by Executive of his duties hereunder. Executive agrees that, if she receives a subpoena or other court order or is otherwise required by law to provide information to a governmental authority or other person concerning the activities of the Employer or any of its Affiliates, or his activities in connection with the business of the Employer or any of its Affiliates, Executive will immediately notify the Employer of such subpoena, court order or other requirement and deliver forthwith to the Employer a copy thereof and any attachments and non-privileged correspondence related thereto. Executive shall take reasonable precautions to protect against the inadvertent disclosure of Confidential Information. Executive agrees to abide by the Employer’s reasonable policies, as in effect from time to time, respecting avoidance of interests conflicting with those of the Employer and its Affiliates. In this regard, Executive shall not directly or indirectly render services to any person or entity where Executive’s service would involve the use or disclosure of Confidential Information. Executive agrees not to use any Confidential Information to guide his in searching publications or other publicly available information, selecting a series of items of knowledge from unconnected sources and fitting them together to claim that he did not violate any agreements set forth in this Agreement.

(b) **Documents and Property.** All records, files, documents and other materials or copies thereof relating to the business of the Employer and its Affiliates, which Executive shall prepare, receive, or use, shall be and remain the sole property of the Employer and, other than in connection with performance by Executive of his duties hereunder, shall not be removed from the premises of the Employer or any of its Affiliates without the Employer’s prior written consent, and shall be promptly returned to the Employer upon Executive’s termination of employment together with all copies (including copies or recordings in electronic form), abstracts, notes or reproductions of any kind made from or about the records, files, documents or other materials.

(c) **Non-Solicitation and Non-Competition.** The Employer and Executive have agreed that the primary service area of the Employer’s lending and deposit taking functions in which Executive will actively participate extends separately to an area that encompasses a twenty-five (25) mile radius from any office or location of the Employer or its affiliates at which Executive services or had supervisory responsibility, in each of the 18 months prior to termination. (collectively, the “**Restricted Area**”). Therefore, as an essential ingredient of and in consideration

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of this Agreement and his employment by the Employer, Executive agrees that, during his employment with the Employer and for a period of twelve (12) months immediately following the termination of his employment (the “**Restricted Period**”), for whatever reason, where such termination occurs during the Employment Period or thereafter, he will not, except with the express prior written consent of the Employer, directly or indirectly, do any of the following (all of which are collectively referred to in this agreement as the “**Restrictive Covenant**”):

(i) Executive will not, directly or indirectly, either for himself/herself, or any Financial Institution: (1) induce or attempt to induce any employee of the Employer or any of its Affiliates to leave the employ of the Employer or any of its Affiliates; (2) in any way interfere with the relationship between the Employer or any of its Affiliates and any employee of the Employer or any of its Affiliates; or (3) induce or attempt to induce any customer, supplier, licensee, or business relation of the Employer or any of its Affiliates to cease doing business with the Employer or any of its Affiliates or in any way interfere with the relationship between the Employer or any of its Affiliates and their respective customers, suppliers, licensees or business relations.

(ii) Executive will not, directly or indirectly, either for himself/herself, or any Financial Institution, solicit the business of any person or entity known to Executive to be a customer of the Employer or any of its Affiliates, where Executive, or any person reporting to Executive, had personal contact with such person or entity, with respect to products, activities or services which compete in whole or in part with the products, activities or services of the Employer or any of its Affiliates.

(iii) Engage or invest in, own, manage, operate, finance, control, or participate in the ownership, management, operation or control of, be employed by, associated with, or in any manner connected with, serve as a director, officer or consultant to, lend his name or any similar name to, lend his credit to, or render services or advice to, any person, firm, partnership, corporation or trust which owns, operates or is in the process of forming, a bank, savings and loan association, credit union or similar financial institution (a “**Financial Institution**”) with an office located, or to be located at an address identified in a filing with any regulatory authority, within the Restricted Area; *provided however*, that the ownership by Executive of shares of the capital stock of any Financial Institution which shares are listed on a securities exchange or quoted on the National Association of Securities Dealers Automated Quotation System and which do not represent more than five percent (5%) of the institution’s outstanding capital stock, shall not violate any terms of this Agreement.

(iv) Executive will not, directly or indirectly, serve as the agent, broker or representative of, or otherwise assist, any person or entity in obtaining services or products from any Financial Institution within the Restricted Area, with respect to the products, activities or services which compete in whole or in part with the products, activities or services of the Employer or any of its Affiliates.

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Notwithstanding the foregoing, in the event of a Termination or resignation for Good Reason paragraphs **8(c)(iii)** and **8(c)(iv)** shall not apply.

**(d) Work for Hire Provisions.**

(i) **Exclusive Rights of the Employer in Work Product.** The parties acknowledge and agree that all work performed by Executive for the Employer or any of its Affiliates shall be deemed “work for hire.” The Employer shall at all times own and have exclusive right, title and interest in and to all Confidential Information and Inventions (as defined below), and the Employer shall retain the exclusive right to license, sell, transfer and otherwise use and dispose of the same. Any and all enhancements of the technology of the Employer or any of its Affiliates that are developed by Executive shall be the exclusive property of the Employer. Executive hereby assigns to the Employer any right, title and interest in and to all Inventions that he/she may have, by law or equity, without additional consideration of any kind whatsoever from the Employer or any of its Affiliates. Executive agrees to execute and deliver any instruments or documents and to do all other things (including the giving of testimony) requested by the Employer (both during and after the termination of his employment with the Employer) in order to vest more fully in the Employer or any of its Affiliates all ownership rights in the Inventions (including obtaining patent, copyright or trademark protection therefore in the United States and/or foreign countries).

(ii) **Definitions and Exclusions.** For purposes of this Agreement, “**Inventions**” means all systems, procedures, techniques, manuals, data bases, plans, lists, inventions, trade secrets, copyrights, patents, trademarks, discoveries, innovations, concepts, ideas and software conceived, compiled or developed by Executive in the course of his employment with the Employer or any of its Affiliates and/or comprised, in whole or part, of Confidential Information. Notwithstanding the foregoing, Inventions shall not include: (i) any inventions independently developed by Executive and not derived, in whole or part, from any Confidential Information or (ii) any invention made by Executive prior to his exposure to any Confidential Information.

(e) **Remedies for Breach of Restrictive Covenants.** Executive has reviewed the provisions of this Agreement with legal counsel, or has been given adequate opportunity to seek such counsel, and Executive acknowledges and expressly agrees that the covenants contained in this **Section 8** are reasonable with respect to their duration, geographical area and scope. Executive further acknowledges that the restrictions contained in this **Section 8** are reasonable and necessary for the protection of the legitimate business interests of the Employer, that they create no undue hardships, that any violation of these restrictions would cause substantial injury to the Employer and such interests, and that such restrictions were a material inducement to the Employer to enter into this Agreement. In the event of any violation or threatened violation of these restrictions, the Employer, in addition to and not in limitation of, any other rights, remedies or damages available to the Employer under this Agreement or otherwise at law or in equity, shall be entitled to preliminary and permanent injunctive relief to prevent or restrain any such violation by Executive and any and all persons directly or indirectly acting for or with her, as the case may be.

(f) In the event of the existence of any other agreement between the parties which (i) is in effect during the Restricted Period, and (ii) which contains restrictive covenants that

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conflict with any of the provisions of this **Section 8**, then the more restrictive of such provisions from the agreements shall control for the period during which the agreements would otherwise be in effect.

(g) Nothing contained herein shall impede Executive's ability to communicate with the staff of the Securities and Exchange Commission or other governmental agencies regarding possible federal securities law violations (i) without the Company's prior approval, and (ii) without having to forfeit or forgo any resulting whistleblower awards.

9. **No Set-Off; No Mitigation.** Except as provided herein, the Employer's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including any set-off, counterclaim, recoupment, defense or other right which the Employer may have against Executive or others. In no event shall Executive be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to Executive under any of the provisions of this Agreement, and such amounts shall not be reduced whether or not Executive obtains other employment.

10. **Notices.** Notices and all other communications under this Agreement shall be in writing and shall be deemed given when mailed by United States registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to the Employer (with a copy to the Company):

Midland States Bancorp, Inc.  
Attention: Chief Executive Officer and Corporate Counsel  
1201 Network Centre Drive  
Effingham, Illinois 62401

If to Executive, to such home address or other address as Executive has most recently provided to the Employer.

or to such other address as either party may furnish to the other in writing, except that notices of changes of address shall be effective only upon receipt.

11. **Applicable Law.** All questions concerning the construction, validity and interpretation of this Agreement and the performance of the obligations imposed by this Agreement shall be governed by the internal laws of the State of Illinois applicable to agreements made and wholly to be performed in such state without regard to conflicts of law provisions of any jurisdiction, and any court action commenced to enforce this Agreement shall have as its sole and exclusive venue the County of Effingham, Illinois.

12. **Entire Agreement; Survival.**

(a) This Agreement constitutes the entire agreement between Executive and the Employer concerning the subject matter hereof, and supersedes all prior negotiations, undertakings, agreements and arrangements with respect thereto, whether written or oral, specifically including the Prior Agreement. If a court of competent jurisdiction determines that any provision of this Agreement is invalid or unenforceable, then the invalidity or unenforceability

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of that provision shall not affect the validity or enforceability of any other provision of this Agreement and all other provisions shall remain in full force and effect. The various covenants and provisions of this Agreement are intended to be severable and to constitute independent and distinct binding obligations. Without limiting the generality of the foregoing, if the scope of any covenant contained in this Agreement is too broad to permit enforcement to its full extent, such covenant shall be enforced to the maximum extent permitted by law, and Executive hereby agrees that such scope may be judicially modified accordingly.

(b) The provisions of **Section 8** shall survive the termination of this Agreement.

**13. Withholding of Taxes.** The Employer may withhold from any benefits payable under this Agreement all federal, state, city or other taxes as may be required pursuant to any law, governmental regulation or ruling.

**14. No Assignment.** Executive's rights to receive payments or benefits under this Agreement shall not be assignable or transferable whether by pledge, creation of a security interest or otherwise, other than a transfer by will or by the laws of descent or distribution. In the event of any attempted assignment or transfer contrary to this Section, the Employer shall have no liability to pay any amount so attempted to be assigned or transferred. This Agreement shall inure to the benefit of and be enforceable by Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees.

**15. Successors.** This Agreement shall be binding upon and inure to the benefit of the Employer, its successors and assigns (including, without limitation, any company into or with which the Employer may merge or consolidate). The Employer agrees that it will not affect the sale or other disposition of all or substantially all of its assets (where such transaction would constitute a Change in Control) unless either (a) the person or entity acquiring the assets, or a substantial portion of the assets, shall expressly assume by an instrument in writing all duties and obligations of the Employer under this Agreement, or (b) the Employer shall provide, through the establishment of a separate reserve, for the payment in full of all amounts which are or may reasonably be expected to become payable to Executive under this Agreement.

**16. Legal Fees.** In the event that either party commences arbitration or litigation to enforce or protect his and/or its rights under this Agreement, the prevailing party in any such action shall be entitled to recover reasonable attorneys' fees and costs (including the costs of experts, evidence and counsel) relating to such action, in addition to all other entitled relief, including but not limited to damages and injunctive relief.

**17. Amendment.** This Agreement may not be amended or modified except by written agreement signed by Executive and the Employer.

**18. Internal Revenue Code Section 409A.**

(a) It is intended that this Agreement comply with the provisions of Section 409A of the Code so as not to subject Executive to the payment of additional taxes and interest under Section 409A of the Code. In furtherance of this intent, this Agreement shall be interpreted, operated and administered in a manner consistent with these intentions, and to the extent that any regulations or other guidance issued under Section 409A of the Code would result in Executive

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being subject to payment of additional income taxes or interest under Section 409A of the Code, the parties agree to amend this Agreement to maintain to the maximum extent practicable the original intent of the Agreement while avoiding the application of such taxes or interest under Section 409A of the Code.

(b) Notwithstanding any provision in this Agreement to the contrary, if Executive is determined to be a Specified Employee as of the Termination Date, then, to the extent required pursuant to Section 409A(a)(2)(B)(i) of the Code, payments due under this Agreement which are deemed to be deferred compensation shall be subject to a six (6) month delay following the Termination Date. For purposes of Section 409A of the Code, all installment payments of deferred compensation made hereunder, or pursuant to another plan or arrangement, shall be deemed to be separate payments and, accordingly, the aforementioned deferral shall only apply to separate payments which would occur during the six (6) month deferral period and all other payments shall be unaffected. All delayed payments shall be accumulated and paid in a lump-sum catch-up payment as of the first day of the seventh-month following the Termination Date (or, if earlier, the date of death of Executive) with all such delayed payments being credited with interest (compounded monthly) for this period of delay equal to the prime rate in effect on the first day of such six-month period. Any portion of the benefits hereunder that were not otherwise due to be paid during the six-month period following the Termination Date shall be paid to Executive in accordance with the payment schedule established herein.

(c) The term “**Specified Employee**” shall mean any person who is a “key employee” (as defined in Code Section 416(i) of the Code without regard to paragraph (5) thereof), as determined by the Employer based upon the 12-month period ending on each December 31st (such 12-month period is referred to below as the “identification period”). If Executive is determined to be a key employee under Section 416(i) of the Code (without regard to paragraph (5) thereof), he/she shall be treated as a Specified Employee for purposes of this Agreement during the 12-month period that begins on the April 1 following the close of such identification period. For purposes of determining whether Executive is a key employee under Section 416(i) of the Code, “compensation” shall mean Executive’s W-2 compensation as reported by the Employer for a particular calendar year.

*(remainder of page intentionally left blank)*

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IN WITNESS WHEREOF, the parties have executed this Agreement as of the Effective Date.

**MIDLAND STATES BANK**

**JAMES STEWART**

By: /s/ Leon J. Holschbach

/s/ James R. Stewart

Name: Leon J. Holschbach

Its: Chief Executive Officer

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**General Release and Waiver**

**This General Release and Waiver** (the “**Release**”) is made and entered into as of this \_\_\_\_ day of \_\_\_\_\_, 20\_\_, by and between Midland States Bank, an Illinois banking corporation (the “**Employer**”), and James Stewart (“**Executive**”).

FOR VALUABLE CONSIDERATION, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

**1. Termination of Employment.** Executive and the Employer agree that Executive’s employment with the Employer terminated effective \_\_\_\_\_. Executive further agrees that without prior written consent of the Employer he/she will not hereafter seek reinstatement, recall or reemployment with the Employer.

**1. Severance Payment.**

**(a)** A description of the payments to which Executive may be entitled upon termination of employment are contained in **Section 6** of that certain Employment Agreement entered into by and between the Employer and Executive dated February 20, 2017, which is incorporated by reference herein (the “**Employment Agreement**”).

**(b)** The payments described in this **Section 3** are over and above that to which Executive would be otherwise entitled to upon the termination of his/her employment with the Employer, absent executing this Release, notwithstanding the terms of the Employment Agreement. Executive affirms that he/she has agreed in the Employment Agreement, and again herein, that he/she is only entitled to such payments if he/she executes this Release.

**1. General Release.** In consideration of the payments and benefits to be made by the Employer to Executive in **Section 3** above, Executive, with full understanding of the contents and legal effect of this Release and having the right and opportunity to consult with his/her counsel, releases and discharges the Employer, its shareholders, officers, directors, supervisors, managers, employees, agents, representatives, attorneys, parent companies, divisions, subsidiaries and affiliates, and all related entities of any kind or nature, and its and their predecessors, successors, heirs, executors, administrators, and assigns (collectively, the “**Released Parties**”) from any and all claims, actions, causes of action, grievances, suits, charges, or complaints of any kind or nature whatsoever, that he/she ever had or now has, whether fixed or contingent, liquidated or unliquidated, known or unknown, suspected or unsuspected, and whether arising in tort, contract, statute, or equity, before any federal, state, local, or private court, agency, arbitrator, mediator, or other entity, regardless of the relief or remedy, arising prior to the execution of this Release. Without limiting the generality of the foregoing, it being the intention of the parties to make this Release as broad and as general as the law permits, this Release specifically includes any and all subject matters and claims arising from any alleged violation by the Released Parties under the Age Discrimination in Employment Act of 1967, as amended; Title VII of the Civil Rights Act of 1964, as amended; the Civil Rights Act of 1866, as amended by the Civil Rights Act of 1991 (42 U.S.C. § 1981); the Rehabilitation Act of 1973, as amended; the Employee Retirement Income

Security Act of 1974, as amended; the Illinois Human Rights Act, and other similar state or local laws; the Americans with Disabilities Act; the Worker Adjustment and Retraining Notification Act; the Equal Pay Act; Executive Order 11246; Executive Order 11141; and any other statutory claim, employment or other contract or implied contract claim, claim for equity in the Employer, or common law claim for wrongful discharge, breach of an implied covenant of good faith and fair dealing, defamation, or invasion of privacy arising out of or involving his employment with the Employer, the termination of his employment with the Employer, or involving any continuing effects of his employment with the Employer or termination of employment with the Employer; provided, however, that nothing herein waives or releases Executive's rights to any payments or benefits the Employer is required to pay or provide pursuant to the terms of the Employment Agreement or this Release or to indemnification which Executive may have under the Employer's governing documents, by any agreement, under any applicable law or otherwise. Executive further acknowledges that he/she is aware that statutes exist that render null and void releases and discharges of any claims, rights, demands, liabilities, action and causes of action which are unknown to the releasing or discharging part at the time of execution of the release and discharge. Executive hereby expressly waives, surrenders and agrees to forego any protection to which he/she would otherwise be entitled by virtue of the existence of any such statute in any jurisdiction including, but not limited to, the State of Illinois.

**1. Covenant Not to Sue.** Executive agrees not to bring, file, charge, claim, sue or cause, assist, or permit to be brought, filed, charged or claimed any action, cause of action, or proceeding regarding or in any way related to any of the claims described in **Section 4** hereof, and further agrees that his Release is, will constitute and may be pleaded as, a bar to any such claim, action, cause of action or proceeding. If any government agency or court assumes jurisdiction of any charge, complaint, or cause of action covered by this Release, Executive will not seek and will not accept any personal equitable or monetary relief in connection with such investigation, civil action, suit or legal proceeding.

**1. No Disparaging, Untrue Or Misleading Statements.** Executive represents that he/she has not made, and agrees that he/she will not make, to any third party any disparaging, untrue, or misleading written or oral statements about or relating to, respectively, the Employer, its products or services (or about or relating to any officer, director, agent, employee, or other person acting on the Employer's behalf), or Executive.

**1. Severability.** If any provision of this Release shall be found by a court to be invalid or unenforceable, in whole or in part, then such provision shall be construed and/or modified or restricted to the extent and in the manner necessary to render the same valid and enforceable, or shall be deemed excised from this Release, as the case may require, and this Release shall be construed and enforced to the maximum extent permitted by law, as if such provision had been originally incorporated herein as so modified or restricted, or as if such provision had not been originally incorporated herein, as the case may be. The parties further agree to seek a lawful substitute for any provision found to be unlawful; provided, that, if the parties are unable to agree upon a lawful substitute, the parties desire and request that a court or other authority called upon to decide the enforceability of this Release modify the Release so that, once modified, the Release will be enforceable to the maximum extent permitted by the law in existence at the time of the requested enforcement.

1. **Waiver.** A waiver by the Employer of a breach of any provision of this Release by Executive shall not operate or be construed as a waiver or estoppel of any subsequent breach by Executive. No waiver shall be valid unless in writing and signed by an authorized officer of the Employer.

1. **Non-Disclosure.** Executive agrees that he/she will keep the terms and amounts set forth in this Release completely confidential and will not disclose any information concerning this Release's terms and amounts to any person other than his/her attorney, accountant, tax advisor, or immediate family, until such time as the information in this Release is disclosed by the Employer as may be required by law.

1. **Restrictive Covenants.** Executive agrees that he/she will abide by the terms set forth in Section 8 of the Employment Agreement.

1. **Return of Employer Materials.** Executive represents that he/she has returned all Employer property and all originals and all copies, including electronic and hard copy, of all documents, within his possession at the time of the execution of this Release, including but not limited to the laptop computer, printer, Blackberry device, telephone, and credit card, as may be applicable.

1. **Representation.** Executive hereby agrees that this Release is given knowingly and voluntarily and acknowledges that:

- (a) this Release is written in a manner understood by Executive;
- (b) this Release refers to and waives any and all rights or claims that he/she may have arising under the Age Discrimination in Employment Act, as amended;
- (c) Executive has not waived any rights arising after the date of this Release;
- (d) Executive has received valuable consideration in exchange for the Release in addition to amounts Executive is already entitled to receive; and
- (e) Executive has been advised to consult with an attorney prior to executing this Release.

1. **Consideration and Revocation.** Executive is receiving this Release on \_\_\_\_\_, 20\_\_, and Executive shall be given twenty-one (21) days from receipt of this Release to consider whether to sign the Release. Executive agrees that changes or modifications to this Release do not restart or otherwise extend the above twenty-one (21) day period, unless specifically agreed to in writing by the Employer. Moreover, Executive shall have seven (7) days following execution to revoke this Release in writing to the Secretary of the Employer and the Release shall not take effect until those seven (7) days have ended.

1. **Future Cooperation.** In connection with any and all claims, disputes, negotiations, investigations, lawsuits or administrative proceedings involving the Employer which relate to periods of time during the Employment Period (as defined in the Employment Agreement), Executive agrees to make himself/herself reasonably available, upon reasonable

notice from the Employer and without the necessity of subpoena, to provide information or documents, provide declarations or statements to the Employer, meet with attorneys or other representatives of the Employer, prepare for and give depositions or testimony, and/or otherwise cooperate in the investigation, defense or prosecution of any or all such matters. Executive shall be reimbursed for reasonable costs and expenses incurred by him as a result of actions taken pursuant to this **Section 13**. It is expressly agreed and understood that Executive will provide only truthful testimony if required to do so, and that any payment to him is solely to reimburse his expenses and costs for cooperation with the Employer. Nothing in this **Section 14** is intended to require Executive to expend an unreasonable period of time in activities required by this Section.

1. **Amendment.** This Release may not be altered, amended, or modified except in writing signed by both Executive and the Employer.

1. **Joint Participation.** The parties hereto participated jointly in the negotiation and preparation of this Release, and each party has had the opportunity to obtain the advice of legal counsel and to review and comment upon the Release. Accordingly, it is agreed that no rule of construction shall apply against any party or in favor of any party. This Release shall be construed as if the parties jointly prepared this Release, and any uncertainty or ambiguity shall not be interpreted against one party and in favor of the other.

1. **Binding Effect; Assignment.** This Release and the various rights and obligations arising hereunder shall inure to the benefit of and be binding upon the parties and their respective successors, heirs, representatives and permitted assigns. Neither party may assign its respective interests hereunder without the express written consent of the other party.

1. **Applicable Law.** All questions concerning the construction, validity and interpretation of this Release and the performance of the obligations imposed by this Release shall be governed by the internal laws of the State of Illinois applicable to agreements made and wholly to be performed in such state without regard to conflicts of law provisions of any jurisdiction and any court action commenced to enforce this Release shall have as its sole and exclusive venue the County of Effingham, Illinois.

1. **Execution of Release.** This Release may be executed in several counterparts, each of which shall be considered an original, but which when taken together, shall constitute one Release.

PLEASE READ THIS RELEASE AND CAREFULLY CONSIDER ALL OF ITS PROVISIONS BEFORE SIGNING IT. THIS RELEASE CONTAINS A RELEASE OF ALL KNOWN AND UNKNOWN CLAIMS, INCLUDING THOSE UNDER THE FEDERAL AGE DISCRIMINATION IN EMPLOYMENT ACT, AND OTHER FEDERAL, STATE AND LOCAL LAWS PROHIBITING DISCRIMINATION IN EMPLOYMENT.

**If Executive signs this Release less than 21 days after he/she receives it from the Employer, he/she confirms that he/she does so voluntarily and without any pressure or coercion from anyone at the Employer.**

**IN WITNESS WHEREOF**, the parties have executed this Release as of the date first stated above.

By:

Name: \_

Its:

[Signature]

Jim Stewart Employment Agreement marked up version (2-20-17

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## AMENDMENT NO. 1 TO EMPLOYMENT AGREEMENT

**THIS AMENDMENT NO. 1 TO EMPLOYMENT AGREEMENT** (this “**Amendment**”) is made and entered into as of December 15, 2017 (the “**Effective Date**”) by and between Midland States Bank, an Illinois banking corporation (the “**Bank**”, hereinafter referred to as the “**Employer**”), and James R. Stewart (“**Executive**”).

## RECITALS

- A. The Executive is currently employed as Chief Risk Officer of the Bank and has entered into an Employment Agreement with the Bank, dated as of February 20, 2017 (the “**Employment Agreement**”).
- B. The Chief Executive Officer of the Bank has recommended, and the Midland States Bancorp, Inc. (the “**Company**”) Compensation Committee has approved, changes to the target Incentive Bonus and long-term incentive bonus percentages for the Executive.

## AGREEMENTS

1. The reference in Section 4(b) of the Employment Agreement to a target Incentive Bonus is hereby amended to “not less than forty percent (40%)”; and a new sentence shall be added as follows: “The long-term incentive bonus percentage for the Executive shall be forty-five percent (45%).”

In all other respects the Employment Agreement shall remain fully in force and effect.

**IN WITNESS WHEREOF**, the parties have executed this Amendment as of the Effective Date.

**MIDLAND STATES BANK**

**JAMES R. STEWART**

By: /s/ Leon J. Holschbach  
 Name: Leon J. Holschbach  
 Its: Chief Executive Officer

/s/ James R. Stewart  
 [Signature]

## AMENDMENT NO. 3 TO EMPLOYMENT AGREEMENT

**THIS AMENDMENT NO. 3 TO EMPLOYMENT AGREEMENT** (this “**Amendment**”) is made and entered into as of January 1, 2019 (the “**Effective Date**”) by and between Midland States Bancorp, Inc. (the “**Company**”), Midland States Bank, an Illinois banking corporation (the “**Bank**”) (the Bank and the Company hereinafter collectively referred to as the “**Employer**”), and Jeffrey G. Ludwig (“**Executive**”).

## RECITALS

- A. Prior to the date of this Amendment Executive served as President of the Company and Chief Executive Officer of the Bank, and has entered into an Employment Agreement with the Company and the Bank, dated as of December 1, 2010, as amended by that certain Amendment No. 1 to Employment Agreement dated as of February 2, 2016 and Amendment No. 2 dated as of December 15, 2017 (the “**Employment Agreement**”).
- B. The Board of Directors of the Company has appointed the Executive Chief Executive Officer of the Company, effective January 1, 2019.
- C. Additionally, the Company’s Compensation Committee has approved increases to the Executive’s target Incentive Bonus and long-term incentive bonus percentages and instructed that an amendment to Executive’s Employment Agreement be executed reflecting such increases.

## AGREEMENTS

Now therefore, the Employment Agreement is hereby amended as follows:

1. Section 3 (Duties) of the Employment Agreement is hereby replaced in its entirety with the following:

“Executive agrees that during the Employment Period, Executive will devote his full business time, energies and talents to serving as President and Chief Executive Officer of the Company and Chief Executive Officer the Bank at the direction of the Company’s and the Bank’s board of directors, respectively. Executive shall have such duties and responsibilities as may be assigned to Executive from time to time by the Company’s and the Bank’s boards of directors, which duties and responsibilities shall be commensurate with Executive’s position, shall perform all duties assigned to Executive faithfully and efficiently, subject to the direction of the respective board of directors, and shall have such authorities and powers as are inherent to the undertakings applicable to Executive’s position and necessary to carry out the responsibilities and duties of Executive. Executive will perform the duties required by this Agreement at the Company’s principal place of business unless the nature of such duties requires otherwise. Notwithstanding the foregoing, during the Employment Period, Executive may devote reasonable time to activities other than those required under this Agreement, including activities of a charitable, educational, religious or similar nature (including professional associations) to the extent such activities do not, in the reasonable judgment of the Company’s board of directors, inhibit, prohibit, interfere with or conflict with Executive’s duties under this Agreement or conflict in any material way with the business of the Employer and its Affiliates; *provided, however*, that Executive shall not serve on the board of directors of any business (other than the Employer or its Affiliates) or hold any other position with any business without receiving the prior written consent of the Company’s board of directors.”

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2. The reference in Section 4(b) of the Employment Agreement to a target Incentive Bonus is hereby amended to “not less than sixty-five percent (65%)”; and the reference to a long-term incentive bonus percentage for the Executive is hereby amended to “sixty-five percent (65%).”

In all other respects the Employment Agreement shall remain fully in force and effect.

**IN WITNESS WHEREOF**, the parties have executed this Amendment as of the Effective Date.

**MIDLAND STATES BANCORP, INC. and  
MIDLAND STATES BANK**

**JEFFREY G. LUDWIG**

By: /s/ Leon J. Holschbach  
Name: Leon J. Holschbach  
Its: Vice-Chairman

/s/ Jeffrey G. Ludwig  
[Signature]

## LIST OF SUBSIDIARIES OF MIDLAND STATES BANCORP, INC.

<u>Subsidiary</u>	<u>Organized Under Laws of</u>	<u>Percent Owned by the Company</u>
Midland States Bank	State of Illinois	100%
Midland Risk Management Company, Inc.	State of Nevada	100%
Midland Financial Advisors, Inc.	State of Wisconsin	100%
Midland States Preferred Securities Trust	State of Delaware	100% of common securities
Love Savings/Heartland Capital Trust III	State of Delaware	100% of common securities
Love Savings/Heartland Capital Trust IV	State of Delaware	100% of common securities
Grant Park Statutory Trust I	State of Delaware	100% of common securities
Centrue Statutory Trust II	State of Delaware	100% of common securities
Love Funding Corporation	State of Virginia	100% owned by Midland States Bank
Midland Trust Company	State of Illinois	100% owned by Midland States Bank
Heartland Premier, LLC	State of Missouri	51% owned by Midland States Bank

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the Registration Statement No. 333-211963 on Form S-8 and the Registration Statement No. 333-219097 on Form S-3 of Midland States Bancorp, Inc. of our report dated February 27, 2019 relating to the consolidated financial statements appearing in the Annual Report on Form 10-K of Midland States Bancorp, Inc. for the year ended December 31, 2018.

*Crowe LLP*  
Crowe LLP

Indianapolis, Indiana  
February 27, 2019

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**Consent of Independent Registered Public Accounting Firm**

The Board of Directors  
Midland States Bancorp, Inc.:

We consent to the incorporation by reference in the registration statement (No. 333-211963) on Form S-8 and the registration statement (No. 333-219097) on Form S-3 of Midland States Bancorp, Inc. of our report dated March 10, 2017, with respect to the consolidated statements of income, comprehensive income, shareholders' equity, and cash flows of Midland States Bancorp, Inc. for the year ended December 31, 2016, which report appears in the December 31, 2018 annual report on Form 10-K of Midland States Bancorp, Inc.

KPMG LLP

St. Louis, Missouri  
February 27, 2019

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**CERTIFICATIONS REQUIRED BY  
RULE 13a-14(a) OR RULE 15d-14(a)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Jeffrey G. Ludwig, certify that:

1. I have reviewed this Annual Report on Form 10-K (the "Report") of Midland States Bancorp, Inc. (the "Registrant");
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

**MIDLAND STATES BANCORP, INC.**

Dated as of: February 27, 2019

By: /s/ Jeffrey G. Ludwig  
Jeffrey G. Ludwig  
Chief Executive Officer  
(Principal Executive Officer)

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**CERTIFICATIONS REQUIRED BY  
RULE 13a-14(a) OR RULE 15d-14(a)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Stephen A. Erickson, certify that:

1. I have reviewed this Annual Report on Form 10-K (the "Report") of Midland States Bancorp, Inc. (the "Registrant");
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

**MIDLAND STATES BANCORP, INC.**

Dated as of: February 27, 2019

By: /s/ Stephen A. Erickson  
Stephen A. Erickson  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

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**CERTIFICATIONS PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Jeffrey G. Ludwig, Chief Executive Officer of Midland States Bancorp, Inc. (the "Company") certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Annual Report on Form 10-K of the Company for the annual period ended December 31, 2018 (the "Report") fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and
  
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

**MIDLAND STATES BANCORP, INC.**

Dated as of: February 27, 2019

By: /s/ Jeffrey G. Ludwig  
Jeffrey G. Ludwig  
*Chief Executive Officer*  
(Principal Executive Officer)

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**CERTIFICATIONS PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Stephen A. Erickson, Chief Financial Officer of Midland States Bancorp, Inc. (the "Company") certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Annual Report on Form 10-K of the Company for the annual period ended December 31, 2018 (the "Report") fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and
  
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

**MIDLAND STATES BANCORP, INC.**

Dated as of: February 27, 2019

By: /s/ Stephen A. Erickson  
Stephen A. Erickson  
*Chief Financial Officer*  
(Principal Financial and Accounting Officer)

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