

BERKSHIRE HILLS BANCORP INC  
Form 10-Q  
November 09, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: September 30, 2018

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

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

Commission File Number: 001-15781

BERKSHIRE HILLS BANCORP, INC.  
(Exact name of registrant as specified in its charter)

Delaware 04-3510455  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

60 State Street, Boston, Massachusetts 02109  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (800) 773-5601, ext. 133773

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 and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filers," "accelerated filers," "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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes  No

The Registrant had 45,416,443 shares of common stock, par value \$0.01 per share, outstanding as of November 7, 2018.

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FORM 10-Q

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## PART I

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BERKSHIRE HILLS BANCORP, INC.  
CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	September 30, 2018	December 31, 2017
<b>Assets</b>		
Cash and due from banks	\$93,038	\$91,122
Short-term investments	42,696	157,641
Total cash and cash equivalents	135,734	248,763
Trading security, at fair value	11,179	12,277
Marketable equity securities, at fair value	59,734	45,185
Securities available for sale, at fair value	1,391,373	1,380,914
Securities held to maturity (fair values of \$371,775 and \$405,276)	379,404	397,103
Federal Home Loan Bank stock and other restricted securities	76,184	63,085
Total securities	1,917,874	1,898,564
Loans held for sale, at fair value	91,639	153,620
Commercial real estate loans	3,371,773	3,264,742
Commercial and industrial loans	1,902,228	1,803,939
Residential mortgages	2,509,324	2,102,807
Consumer loans	1,121,188	1,127,850
Total loans	8,904,513	8,299,338
Less: Allowance for loan losses	(58,457)	(51,834)
Net loans	8,846,056	8,247,504
Premises and equipment, net	111,130	109,352
Goodwill	518,325	519,287
Other intangible assets	34,620	38,296
Cash surrender value of bank-owned life insurance policies	194,369	191,221
Deferred tax assets, net	56,708	47,061
Other assets	123,604	117,083
Total assets	\$12,030,059	\$11,570,751
<b>Liabilities</b>		
Demand deposits	\$1,563,845	\$1,606,656
NOW and other deposits	844,210	734,558
Money market deposits	2,447,184	2,776,157
Savings deposits	737,682	741,954
Time deposits	3,173,180	2,890,205
Total deposits	8,766,101	8,749,530
Short-term debt	1,187,944	667,300
Long-term Federal Home Loan Bank advances	262,709	380,436
Subordinated borrowings	89,473	89,339
Total borrowings	1,540,126	1,137,075
Other liabilities	191,517	187,882
Total liabilities	\$10,497,744	\$10,074,487
(continued)		

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	September 30, 2018	December 31, 2017
Shareholders' equity		
Preferred Stock (Series B non-voting convertible preferred stock - \$0.01 par value; 2,000,000 shares authorized, 521,607 shares issued and outstanding in 2018; 1,000,000 shares authorized, 521,607 shares issued and outstanding in 2017)	40,633	40,633
Common stock (\$.01 par value; 100,000,000 shares authorized and 46,211,894 shares issued and 45,420,478 shares outstanding in 2018; 50,000,000 shares authorized, 46,211,894 shares issued and 45,290,433 shares outstanding in 2017)	460	460
Additional paid-in capital - common stock	1,244,748	1,242,487
Unearned compensation	(8,661	) (6,531 )
Retained earnings	305,259	239,179
Accumulated other comprehensive (loss) income	(28,647	) 4,161
Treasury stock, at cost (791,416 shares in 2018 and 921,461 shares in 2017)	(21,477	) (24,125 )
Total shareholders' equity	1,532,315	1,496,264
Total liabilities and shareholders' equity	\$ 12,030,059	\$ 11,570,751
The accompanying notes are an integral part of these consolidated financial statements.		

Table of ContentsBERKSHIRE HILLS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Interest and dividend income				
Loans	\$104,273	\$76,024	\$298,757	\$216,950
Securities and other	14,918	13,036	44,553	37,485
Total interest and dividend income	119,191	89,060	343,310	254,435
Interest expense				
Deposits	21,460	10,984	54,553	30,053
Borrowings	8,390	6,078	22,825	15,953
Total interest expense	29,850	17,062	77,378	46,006
Net interest income	89,341	71,998	265,932	208,429
Non-interest income				
Mortgage banking originations	8,971	13,374	29,313	42,333
Loan related income	7,537	6,081	19,524	15,535
Deposit related fees	7,004	6,445	22,675	19,294
Insurance commissions and fees	2,930	2,581	8,504	8,305
Wealth management fees	2,283	2,315	7,160	7,127
Total fee income	28,725	30,796	87,176	92,594
Other, net	468	(2,255 )	1,891	(2,438 )
Gain/(loss) on securities, net	88	(1 )	(696 )	12,568
Gain on sale of business operations and other assets, net	—	296	460	296
Loss on termination of hedges	—	—	—	(6,629 )
Total non-interest income	29,281	28,836	88,831	96,391
Total net revenue	118,622	100,834	354,763	304,820
Provision for loan losses	6,628	4,900	18,735	14,884
Non-interest expense				
Compensation and benefits	39,923	37,643	123,241	110,759
Occupancy and equipment	10,144	8,267	30,456	25,971
Technology and communications	7,949	6,644	22,138	19,614
Marketing and promotion	1,484	2,128	6,465	7,304
Professional services	1,867	2,247	5,059	6,888
FDIC premiums and assessments	1,640	1,651	4,246	4,537
Other real estate owned and foreclosures	(1 )	(23 )	67	35
Amortization of intangible assets	1,218	739	3,732	2,310
Acquisition, restructuring, and other expenses	198	1,420	6,138	16,005
Other	6,555	5,104	18,641	16,246
Total non-interest expense	70,977	65,820	220,183	209,669
Income before income taxes	41,017	30,114	115,845	80,267
Income tax expense	8,790	7,211	24,339	22,210
Net income	\$32,227	\$22,903	\$91,506	\$58,057
Preferred stock dividend	230	—	689	—
Income available to common shareholders	31,997	22,903	90,817	58,057
Earnings per common share:				
Basic	\$0.70	\$0.57	\$1.99	\$1.55



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Diluted	\$0.70	\$0.57	\$1.98	\$1.54
Weighted average shares outstanding:				
Basic	46,030	39,984	46,009	37,547
Diluted	46,263	40,145	46,226	37,708

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income	\$32,227	\$22,903	\$91,506	\$58,057
Other comprehensive income, before tax:				
Changes in unrealized loss on debt securities available-for-sale	(9,929 )	1,461	(36,931 )	(4,044 )
Changes in unrealized loss on derivative hedges	—	—	—	6,573
Income taxes related to other comprehensive income:				
Changes in unrealized loss on debt securities available-for-sale	2,548	(605 )	9,480	1,481
Changes in unrealized gains on derivative hedges	—	—	—	(2,589 )
Total other comprehensive (loss)/income	(7,381 )	856	(27,451 )	1,421
Total comprehensive income	\$24,846	\$23,759	\$64,055	\$59,478

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

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## BERKSHIRE HILLS BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands)	Preferred stock Shares	Preferred stock Amount	Common stock Shares	Common stock Amount	Additional paid-in capital	Unearned compensation	Retained earnings	Accumulated other comprehensive income/(loss)	Treasury stock	Total
Balance at December 31, 2016	—	—	35,673	\$366	\$898,989	\$(6,374)	\$217,494	\$9,766	\$(26,943)	\$1,093,298
Comprehensive income:										
Net income	—	—	—	—	—	—	58,057	—	—	58,057
Other comprehensive loss	—	—	—	—	—	—	—	1,421	—	1,421
Total comprehensive income	—	—	—	—	—	—	58,057	1,421	—	59,478
Common stock issued	—	—	4,638	46	152,879	—	—	—	—	152,925
Cash dividends declared (\$0.63 per share)	—	—	—	—	—	—	(23,515 )	—	—	(23,515 )
Forfeited shares	—	—	(10 )	—	63	304	—	—	(367 )	—
Exercise of stock options	—	—	11	—	—	—	(132 )	—	293	161
Restricted stock grants	—	—	156	—	1,582	(5,565 )	—	—	3,983	—
Stock-based compensation	—	—	—	—	—	3,865	—	—	—	3,865
Other, net	—	—	(44 )	—	(4 )	—	(69 )	—	(1,612 )	(1,685 )
Balance at September 30, 2017	—	—	40,424	\$412	\$1,053,509	\$(7,770)	\$251,835	\$11,187	\$(24,646)	\$1,284,527
Balance at December 31, 2017	522	\$40,633	45,290	\$460	\$1,242,487	\$(6,531)	\$239,179	\$4,161	\$(24,125)	\$1,496,264
Comprehensive income:										
Net income	—	—	—	—	—	—	91,506	—	—	91,506
Other comprehensive loss	—	—	—	—	—	—	—	(27,451 )	—	(27,451 )
Total comprehensive	—	—	—	—	—	—	91,506	(27,451 )	—	64,055

income											
Adoption of ASU No 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Liabilities	—	—	—	—	—	—	6,253	(6,253 )	—	—	
Adoption of ASU No 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	—	—	—	—	—	—	(896 )	896	—	—	
Cash dividends declared on common shares (\$0.66 per share)	—	—	—	—	—	—	(29,972 )	—	—	(29,972 )	
Cash dividends declared on preferred shares (\$1.32 per share)	—	—	—	—	—	—	(689 )	—	—	(689 )	
Forfeited shares	—	—	(18 )	—	88	600	—	—	(688 )	—	
Exercise of stock options	—	—	8	—	—	—	(122 )	—	224	102	
Restricted stock grants	—	—	185	—	2,157	(7,011 )	—	—	4,854	—	
Stock-based compensation	—	—	—	—	—	4,281	—	—	—	4,281	
Other, net	—	—	(45 )	—	16	—	—	—	(1,742 )	(1,726 )	
Balance at September 30, 2018	522	\$40,633	45,420	\$460	\$1,244,748	\$(8,661)	\$305,259	\$(28,647)	\$(21,477)	\$1,532,315	

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



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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income	\$ 91,506	\$ 58,057
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	18,735	14,884
Net amortization of securities	2,166	2,103
Change in unamortized net loan costs and premiums	(1,963 )	1,388
Premises and equipment depreciation and amortization expense	8,047	7,448
Stock-based compensation expense	4,281	3,865
Accretion of purchase accounting entries, net	(15,735 )	(11,837 )
Amortization of other intangibles	3,732	2,310
Write down of other real estate owned	—	10
Income from cash surrender value of bank-owned life insurance policies	(3,607 )	(2,343 )
Securities losses (gains), net	696	(12,568 )
Originations of loans held for sale	(1,604,993 )	(1,769,385 )
Proceeds from sale of loans held for sale	1,696,287	1,788,646
Net gain on sale of loans and other mortgage banking income	(29,313 )	(42,333 )
Loss on disposition of assets	—	912
	—	(54 )

Gain on sale of real estate			
Amortization of interest in tax-advantaged projects	3,212		6,129
Net change in other	8,640		3,602
Net cash provided by operating activities	181,691		50,834
Cash flows from investing activities:			
Net decrease in trading security	495		468
Proceeds from sales of securities available for sale	499		44,446
Proceeds from maturities, calls, and prepayments of securities available for sale	142,314		139,434
Purchases of securities available for sale	(223,337)	)	(329,385)
Proceeds from sales of marketable equity securities	32,137		44,994
Purchases of marketable equity securities	(18,649)	)	(20,618)
Proceeds from maturities, calls, and prepayments of securities held to maturity	29,069		8,094
Purchases of securities held to maturity	(12,865)	)	(70,153)
Net change in loans	(609,637)	)	(330,869)
Purchases of bank owned life insurance	—		(20,000)
Proceeds from surrender of bank-owned life insurance	459		310
Proceeds from sale of Federal Home Loan Bank stock	49,793		72,642
Purchase of Federal Home Loan Bank stock	(62,892)	)	(76,646)
	(3,815)	)	(4,742)

Net investment in limited partnership tax credits				
Purchase of premises and equipment, net	(9,648	)	(9,740	)
Payment to terminate cash flow hedges	—		6,573	
Proceeds from sale of other real estate	1,600		352	
Net cash (used) by investing activities	(684,477	)	(544,840	)

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(In thousands) (continued)	Nine Months Ended September 30,	
	2018	2017
Cash flows from financing activities:		
Net increase in deposits	17,419	170,381
Proceeds from Federal Home Loan Bank advances and other borrowings	3,673,840	5,291,601
Repayments of Federal Home Loan Bank advances and other borrowings	(3,270,943)	(5,116,876)
Exercise of stock options	102	161
Common and preferred stock cash dividends paid	(30,661 )	(23,515 )
Common stock issued, net	—	152,925
Acquisition contingent consideration paid	—	(1,700 )
Net cash provided by financing activities	389,757	472,977
Net change in cash and cash equivalents	(113,029 )	(21,029 )
Cash and cash equivalents at beginning of period	248,763	113,075
Cash and cash equivalents at end of period	\$ 135,734	\$ 92,046
Supplemental cash flow information:		
Interest paid on deposits	\$52,539	\$ 29,822
Interest paid on borrowed funds	22,824	15,775
Income taxes paid (refund), net	758	9,467
Other non-cash changes:		
Other net comprehensive income	(27,451 )	1,421
Real estate owned acquired in settlement of loans	(1,600 )	444

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The consolidated financial statements (the “financial statements”) of Berkshire Hills Bancorp, Inc. and its subsidiaries (the “Company” or “Berkshire”) have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The Company is a Delaware corporation and the holding company for Berkshire Bank (the “Bank”), a Massachusetts-chartered trust company headquartered in Boston, Massachusetts, and Berkshire Insurance Group, Inc. These financial statements include the accounts of the Company, its wholly-owned subsidiaries and the Bank’s consolidated subsidiaries. In consolidation, all significant intercompany accounts and transactions are eliminated. All material wholly-owned and majority-owned subsidiaries are consolidated unless GAAP requires otherwise.

The Company has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

These interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X, and accordingly, certain information and footnote disclosures normally included in financial statements prepared according to GAAP have been omitted.

The results for any interim period are not necessarily indicative of results for the full year. These consolidated financial statements should be read in conjunction with the audited financial statements and note disclosures Berkshire Hills Bancorp, Inc. previously filed with the Securities and Exchange Commission in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In management’s opinion, all adjustments necessary for a fair statement are reflected in the interim periods presented.

Reclassifications

Certain items in prior financial statements have been reclassified to conform to the current presentation.

Prior Period Acquisition

The Company completed the acquisition of Commerce Bancshares Corp. (“Commerce”), the parent company of Commerce Bank & Trust Company (“Commerce Bank”), at the close of business on October 13, 2017. With this acquisition, the Company established a market position in Worcester, New England’s second largest city. Additionally, this acquisition was a catalyst for the Company’s decision to relocate its corporate headquarters to Boston and to expand its Greater Boston market initiatives. This acquisition also increased the Company’s total assets over the \$10 billion Dodd Frank Act threshold for additional regulatory requirements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During the nine months ended September 30, 2018, immaterial adjustments were made to the preliminary valuation of the assets acquired and liabilities assumed. These adjustments affect goodwill, other assets, and deferred tax assets. As of September 30, 2018, the Company finalized its valuation of all assets acquired and liabilities assumed, resulting in no material change to acquisition accounting adjustments. A summary of the fair values of the acquired assets, liabilities assumed, and resulting goodwill follows:

(In thousands)	As Acquired	Fair Value Adjustments	As Recorded by the Company
<b>Consideration Paid:</b>			
Company common stock issued to Commerce common shareholders			\$ 188,599
Company preferred stock issued to certain Commerce shareholders			40,633
Cash in lieu paid to Commerce shareholders			1
Total consideration paid			229,233
<b>Recognized amounts of identifiable assets acquired and (liabilities) assumed, at fair value:</b>			
Cash and short-term investments	\$ 374,611	—	\$ 374,611
Investment securities	115,274	(1,427 )	113,847
Loans, net	1,327,256	(86,505 )	1,240,751
Premises and equipment	8,931	5,346	14,277
Core deposit intangibles	—	22,400	22,400
Deferred tax assets, net	7,956	27,060	35,016
Goodwill and other intangibles	11,233	(11,233 )	—
Other assets	52,709	(3,182 )	49,527
Deposits	(1,710,872)	(1,180 )	(1,712,052)
Borrowings	(19,542 )	—	(19,542 )
Other liabilities	(5,086 )	265	(4,821 )
Total identifiable net assets	\$ 162,470	(48,456 )	114,014
Goodwill			115,219

**Recently Adopted Accounting Principles**

Effective January 1, 2018, the following new accounting guidance was adopted by the Company:

• ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) (additional information is disclosed in Note 14 - Revenue of the consolidated financial statements);

• ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

The adoption of these accounting standards did not have a material impact on the Company's financial statements.

In February 2018, the FASB issued ASU No. 2018-02, "Income statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" which will allow a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. These amendments are effective for all entities for fiscal years beginning after December 15, 2018. For interim periods within those fiscal years, early adoption of the amendment is permitted including public business entities for reporting periods for which financial statements have not yet been issued. The Company elected to early adopt ASU 2018-02 during the first quarter of 2018, and elected to reclassify

the income tax effects of the Tax Cuts and Jobs Act of 2017 from AOCI to retained earnings. The immaterial reclassification increased AOCI and decreased retained earnings by \$896 thousand, with no net effect on total shareholders' equity.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Future Application of Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)". The new pronouncement improves the transparency and comparability of financial reporting around leasing transactions and more closely aligns accounting for leases with the recently issued International Financial Reporting Standard. The pronouncement affects all entities that are participants to leasing agreements. From a lessee accounting perspective, the ASU requires a lessee to recognize assets and liabilities on the balance sheet for operating leases and changes many key definitions, including the definition of a lease. The ASU includes a short-term lease exception for leases with a term of twelve months or less, in which a lessee can make an accounting policy election not to recognize lease assets and lease liabilities. Lessees will continue to differentiate between finance leases (previously referred to as capital leases) and operating leases, using classification criteria that are substantially similar to the previous guidance. For lessees, the recognition, measurement, and presentation of expenses and cash flows arising from a lease have not significantly changed from previous GAAP. From a lessor accounting perspective, the guidance is largely unchanged, except for targeted improvements to align with new terminology under lessee accounting and with the updated revenue recognition guidance in Topic 606. For sale-leaseback transactions, for a sale to occur the transfer must meet the sale criteria under the new revenue standard, Topic 606. Entities will not be required to reassess transactions previously accounted under then existing guidance.

The ASU includes additional quantitative and qualitative disclosures required by lessees and lessors to help users better understand the amount, timing, and uncertainty of cash flows arising from leases. ASU No. 2016-02 is effective for fiscal years beginning after December 31, 2018, and interim periods within those fiscal years. Lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. In July 2018, the FASB issued ASU No. 2018-11, "Leases (Topic 842) - Targeted Improvements" to provide entities with relief from the costs of implementing certain aspects of the new leasing standard. Specifically, under the amendments in ASU No. 2018-11 entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and lessors may elect not to separate lease and non-lease components when certain conditions are met. As the Company expects to elect the transition option provided in ASU No. 2018-11, the modified retrospective approach will be applied on January 1, 2019 (as opposed to January 1, 2017). The Company also expects to elect certain practical expedients provided under ASU No. 2016-02 whereby we will not reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases and (iii) initial direct costs for any existing leases. The Company continues to evaluate the provisions of ASU No. 2016-02 to determine the potential impact the new standard will have on the Company's consolidated financial statements. It is expected that assets and liabilities will increase based on the present value of remaining lease payments for leases in place at the adoption date; however, this is not expected to be material to the Company's results of operations or financial position. The Company is nearing completion of its effort to identify a complete inventory of arrangements containing a lease and accumulating the lease data necessary to apply the guidance. We will continue to review contracts up through the effective date and may identify additional leases or leases embedded in arrangements that will be within the scope of the new guidance.

In June 2016, the FASB issued ASU No. 2016-13 "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This ASU improves financial reporting by requiring timelier recording of credit losses on loans and other financial instruments. The ASU requires companies 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. Forward-looking information will now be used in credit loss estimates. The ASU requires enhanced disclosures to provide better understanding surrounding significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a company's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. Most debt instruments will

require a cumulative-effect adjustment to retained earnings on the statement of financial position as of the beginning of the first reporting period in which the guidance is adopted (modified retrospective approach). However, there is instrument-specific transition guidance. ASU No. 2016-13 is effective for interim and annual

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

periods beginning after December 15, 2019. Early application will be permitted for interim and annual periods beginning after December 15, 2018.

The Company is evaluating the provisions of ASU No. 2016-13, and will closely monitor developments and additional guidance to determine the potential impact on the Company's consolidated financial statements. A cross-functional working group has been formed and is comprised of individuals from various functional areas including credit, risk management, finance and information technology, among others. We are working through our implementation plan which includes assessment and documentation of processes and internal controls; model development and documentation; and system configuration. We are also in the process of implementing a third-party vendor solution to assist us in the application of ASU No. 2016-13. The Company expects the primary changes to be the application of the new expected credit loss model from the incurred model. In addition, the Company expects the guidance to change the presentation of credit losses within the available-for-sale fixed maturities portfolio through an allowance method rather than as a direct write-down. The expected credit loss model will require a financial asset to be presented at the net amount expected to be collected. The allowance method for available-for-sale debt securities will allow the Company to record reversals of credit losses if the estimate of credit losses declines. The Company is in the process of identifying and implementing required changes to loan loss estimation models and processes and evaluating the impact of this new accounting guidance, which at the date of adoption is expected to increase the allowance for credit losses with a resulting negative adjustment to retained earnings.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The ASU simplifies the test for goodwill impairment by eliminating the second step of the current two-step method. Under the new accounting guidance, entities will compare the fair value of a reporting unit with its carrying amount. If the carrying amount exceeds the reporting unit's fair value, the entity is required to recognize an impairment charge for this amount. Current guidance requires an entity to proceed to a second step, whereby the entity would determine the fair value of its assets and liabilities. The new method applies to all reporting units. The performance of a qualitative assessment is still allowable. This accounting guidance is effective prospectively for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not expect adoption to have a material effect on our consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." The purpose of this updated guidance is to better align a company's financial reporting for hedging activities with the economic objectives of those activities. ASU No. 2017-12 is effective for public business entities for fiscal years beginning after December 15, 2018, with early adoption, including adoption in an interim period, permitted. ASU No. 2017-12 requires a modified retrospective transition method in which the Company will recognize the cumulative effect of the change on the opening balance of each affected component of equity in the consolidated balance sheet as of the date of adoption. While the Company continues to assess all potential impacts of the standard, we currently do not expect adoption to have a material impact on our consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement." This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. Entities are also allowed to elect early adoption for the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on our consolidated

financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In August 2018, the FASB issued ASU No. 2018-14, “Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans.” This ASU amends and modifies the disclosure requirements for employers that sponsor defined benefit pension or other post-retirement plans. The amendments in this update remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. ASU No. 2018-14 is effective for fiscal years ending after December 15, 2020, with early adoption permitted. As ASU No. 2018-14 only revises disclosure requirements, it will not have a material impact on our consolidated financial statements.

In August 2018, the FASB issued 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.” ASU No. 2018-15 clarifies certain aspects of ASU No. 2015-05, “Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement,” which was issued in April 2015. Specifically, ASU No. 2018-15 aligns 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 (and hosting arrangements that include an internal-use software license). ASU No. 2018-15 does not affect the accounting for the service element of a hosting arrangement that is a service contract. ASU No. 2018-15 is effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The amendments in this ASU should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. While the Company continues to assess all potential impacts of the standard, we currently do not expect adoption to have a material impact on our consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. TRADING SECURITY

The Company holds a tax advantaged economic development bond accounted for at fair value. The security had an amortized cost of \$10.3 million and \$10.8 million, and a fair value of \$11.2 million and \$12.3 million, at September 30, 2018 and December 31, 2017, respectively. As discussed further in Note 11 - Derivative Financial Instruments and Hedging Activities, the Company entered into a swap contract to swap-out the fixed rate of the security in exchange for a variable rate. The Company does not purchase securities with the intent of selling them in the near term, and there were no other securities in the trading portfolio at September 30, 2018.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 3. SECURITIES AVAILABLE FOR SALE, HELD TO MATURITY, AND MARKETABLE EQUITY SECURITIES

The Company adopted ASU-2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities" in the first quarter of 2018. All changes in the fair value of marketable equity securities, including other-than-temporary impairment, are immediately recognized in earnings.

The following is a summary of securities available for sale, held to maturity, and marketable equity securities:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	\$109,583	\$ 1,447	\$(1,111)	) \$109,919
Agency collateralized mortgage obligations	950,496	4	(31,021)	) 919,479
Agency mortgage-backed securities	182,301	38	(7,583)	) 174,756
Agency commercial mortgage-backed securities	62,526	—	(3,862)	) 58,664
Corporate bonds	108,507	402	(456)	) 108,453
Trust preferred securities	11,143	283	—	) 11,426
Other bonds and obligations	8,780	13	(117)	) 8,676
Total securities available for sale	1,433,336	2,187	(44,150)	) 1,391,373
Securities held to maturity				
Municipal bonds and obligations	269,076	2,711	(6,254)	) 265,533
Agency collateralized mortgage obligations	72,195	2	(2,076)	) 70,121
Agency mortgage-backed securities	7,322	—	(428)	) 6,894
Agency commercial mortgage-backed securities	10,433	—	(566)	) 9,867
Tax advantaged economic development bonds	20,078	12	(1,030)	) 19,060
Other bonds and obligations	300	—	—	) 300
Total securities held to maturity	379,404	2,725	(10,354)	) 371,775
Marketable equity securities	55,545	6,069	(1,880)	) 59,734
Total	\$1,868,285	\$ 10,981	\$(56,384)	) \$1,822,882

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	\$ 113,427	\$ 5,012	\$(206)	\$ 118,233
Agency collateralized mortgage obligations	859,705	397	(8,944)	851,158
Agency mortgage-backed securities	218,926	279	(2,265)	216,940
Agency commercial mortgage-backed securities	64,025	41	(1,761)	62,305
Corporate bonds	110,076	882	(237)	110,721
Trust preferred securities	11,334	343	—	11,677
Other bonds and obligations	9,757	154	(31)	9,880
Total securities available for sale	1,387,250	7,108	(13,444)	1,380,914
Securities held to maturity				
Municipal bonds and obligations	270,310	8,675	(90)	278,895
Agency collateralized mortgage obligations	73,742	1,045	(486)	74,301
Agency mortgage-backed securities	7,892	—	(164)	7,728
Agency commercial mortgage-backed securities	10,481	—	(268)	10,213
Tax advantaged economic development bonds	34,357	596	(1,135)	33,818
Other bonds and obligations	321	—	—	321
Total securities held to maturity	397,103	10,316	(2,143)	405,276
Marketable equity securities	36,483	9,211	(509)	45,185
Total	\$ 1,820,836	\$ 26,635	\$(16,096)	\$ 1,831,375

The amortized cost and estimated fair value of available for sale (“AFS”) and held to maturity (“HTM”) securities segregated by contractual maturity at September 30, 2018 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable.

(In thousands)	Available for sale		Held to maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	\$ 1,331	\$ 1,335	\$ 5,625	\$ 5,625
Over 1 year to 5 years	32,129	32,099	14,330	14,232
Over 5 years to 10 years	75,661	75,882	12,286	12,319
Over 10 years	128,892	129,158	257,213	252,717
Total bonds and obligations	238,013	238,474	289,454	284,893
Mortgage-backed securities	1,195,323	1,152,899	89,950	86,882
Total	\$ 1,433,336	\$ 1,391,373	\$ 379,404	\$ 371,775

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Securities available for sale and held to maturity with unrealized losses, segregated by the duration of their continuous unrealized loss positions, are summarized as follows:

(In thousands)	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
September 30, 2018						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	\$ 404	\$ 18,792	\$ 707	\$ 8,434	\$ 1,111	\$ 27,226
Agency collateralized mortgage obligations	12,063	474,842	18,958	434,009	31,021	908,851
Agency mortgage-backed securities	2,244	69,578	5,339	102,865	7,583	172,443
Agency commercial mortgage-backed securities	362	9,107	3,500	49,557	3,862	58,664
Corporate bonds	456	53,366	—	—	456	53,366
Other bonds and obligations	66	3,537	51	3,065	117	6,602
Total securities available for sale	15,595	629,222	28,555	597,930	44,150	1,227,152
Securities held to maturity						
Municipal bonds and obligations	6,037	147,443	217	1,901	6,254	149,344
Agency collateralized mortgage obligations	1,347	58,734	729	11,325	2,076	70,059
Agency mortgage-backed securities	—	—	428	6,894	428	6,894
Agency commercial mortgage-backed securities	—	—	566	9,867	566	9,867
Tax advantaged economic development bonds	1,030	17,165	—	—	1,030	17,165
Total securities held to maturity	8,414	223,342	1,940	29,987	10,354	253,329
Total	\$ 24,009	\$ 852,564	\$ 30,495	\$ 627,917	\$ 54,504	\$ 1,480,481
December 31, 2017						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	\$ —	\$ —	\$ 206	\$ 8,985	\$ 206	\$ 8,985
Agency collateralized mortgage obligations	6,849	655,479	2,095	80,401	8,944	735,880
Agency mortgage-backed securities	765	95,800	1,500	65,323	2,265	161,123
Agency commercial mortgage-backed securities	334	17,379	1,427	39,268	1,761	56,647
Corporate bonds	1	328	236	15,769	237	16,097
Other bonds and obligations	11	1,096	20	2,004	31	3,100
Total securities available for sale	7,960	770,082	5,484	211,750	13,444	981,832
Securities held to maturity						
Municipal bonds and obligations	35	10,213	55	2,059	90	12,272
Agency collateralized mortgage obligations	—	—	486	12,946	486	12,946
Agency mortgage-backed securities	—	—	164	7,728	164	7,728
Agency commercial mortgage-backed securities	—	—	268	10,213	268	10,213
Tax advantaged economic development bonds	1,135	7,305	—	—	1,135	7,305
Total securities held to maturity	1,170	17,518	973	32,946	2,143	50,464

Total	\$ 9,130	\$ 787,600	\$ 6,457	\$ 244,696	\$ 15,587	\$ 1,032,296
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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Debt Securities

The Company expects to recover its amortized cost basis on all debt securities in its AFS and HTM portfolios. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of September 30, 2018, prior to this recovery. The Company's ability and intent to hold these securities until recovery is supported by the Company's strong capital and liquidity positions as well as its historically low portfolio turnover.

The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company's AFS and HTM portfolios were not other-than-temporarily impaired at September 30, 2018:

#### AFS municipal bonds and obligations

At September 30, 2018, 49 out of the total 250 securities in the Company's portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 3.9% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the quarter. All securities are performing.

#### AFS collateralized mortgage obligations

At September 30, 2018, 243 out of the total 249 securities in the Company's portfolio of AFS collateralized mortgage obligations were in unrealized loss positions. Aggregate unrealized losses represented 3.3% of the amortized cost of securities in unrealized loss positions. The Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), and Government National Mortgage Association ("GNMA") guarantee the contractual cash flows of all of the Company's collateralized mortgage obligations. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

#### AFS commercial and residential mortgage-backed securities

At September 30, 2018, 81 out of the total 98 securities in the Company's portfolio of AFS mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 4.7% of the amortized cost of securities in unrealized loss positions. The FNMA, FHLMC, and GNMA guarantee the contractual cash flows of all of the Company's mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

#### AFS corporate bonds

At September 30, 2018, 12 out of the total 21 securities in the Company's portfolio of AFS corporate bonds were in unrealized loss positions. Aggregate unrealized loss represents 0.9% of the amortized cost of bonds in unrealized loss positions. The Company reviews the financial strength of all of these bonds and has concluded that the amortized cost remains supported by the expected future cash flows of these securities.

#### AFS other bonds and obligations

At September 30, 2018, 7 out of the total 8 securities in the Company's portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 1.7% of the amortized cost of securities in unrealized loss positions. The securities are all investment grade rated, and there were no material underlying credit downgrades during the quarter. All securities are performing.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### HTM Municipal bonds and obligations

At September 30, 2018, 102 out of the total 224 securities in the Company's portfolio of municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 4.0% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the quarter. All securities are performing.

### HTM collateralized mortgage obligations

At September 30, 2018, 6 out of the total 9 securities in the Company's portfolio of HTM collateralized mortgage obligations were in unrealized loss positions. Aggregate unrealized losses represented 5.9% of the amortized cost of securities in unrealized loss positions. The FNMA, FHLMC, and GNMA guarantee the contractual cash flows of all of the Company's collateralized residential mortgage obligations. The securities are investment grade rated, and there were no material underlying credit downgrades during the quarter. All securities are performing.

### HTM commercial and residential mortgage-backed securities

At September 30, 2018, 2 out of the total 2 securities in the Company's portfolio of HTM mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 5.6% of the amortized cost of securities in unrealized loss positions. The FNMA, FHLMC, and GNMA guarantee the contractual cash flows of the Company's residential mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

### HTM tax-advantaged economic development bonds

At September 30, 2018, 4 out of the total 6 securities in the Company's portfolio of tax advantaged economic development bonds were in unrealized loss positions. Aggregate unrealized losses represented 5.7% of the amortized cost of the securities in unrealized loss positions. One of the above mentioned tax advantaged economic bonds was downgraded to special mention during 2017. The Company believes that more likely than not all the principal outstanding will be collected. All securities are performing.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 4. LOANS

The Company's loan portfolio is segregated into the following segments: commercial real estate, commercial and industrial, residential mortgage, and consumer. Commercial real estate loans include construction and other commercial real estate. Residential mortgage loans include classes for 1-4 family owner occupied and construction loans. Consumer loans include home equity, direct and indirect auto, and other. These portfolio segments each have unique risk characteristics that are considered when determining the appropriate level for the allowance for loan losses. A substantial portion of the loan portfolio is secured by real estate in Massachusetts, southern Vermont, northeastern New York, New Jersey and in the Bank's other New England lending areas. The ability of many of the Bank's borrowers to honor their contracts is dependent, among other things, on the specific economy and real estate markets of these areas.

Total loans include business activity loans and acquired loans. Acquired loans are those loans acquired from Commerce Bank and Trust Company, First Choice Bank, Parke Bank, Firestone Financial Corp., Hampden Bancorp, Inc., the New York branch acquisition, Beacon Federal Bancorp, Inc., The Connecticut Bank and Trust Company, Legacy Bancorp, Inc., and Rome Bancorp, Inc. Acquired loans that are refinanced are transferred to business activity loans. Business activity and acquired loans are serviced, managed, and accounted for under the Company's same control environment. The following is a summary of total loans:

(In thousands)	September 30, 2018			December 31, 2017		
	Business Activities	Acquired Loans	Total	Business Activities	Acquired Loans	Total
Commercial real estate:						
Construction	\$321,842	\$52,946	\$374,788	\$269,206	\$84,965	\$354,171
Other commercial real estate	2,118,039	878,946	2,996,985	1,948,501	962,070	2,910,571
Total commercial real estate	2,439,881	931,892	3,371,773	2,217,707	1,047,035	3,264,742
Commercial and industrial loans:	1,422,857	479,371	1,902,228	1,182,569	621,370	1,803,939
Total commercial loans	3,862,738	1,411,263	5,274,001	3,400,276	1,668,405	5,068,681
Residential mortgages:						
1-4 family	2,250,946	247,092	2,498,038	1,808,024	289,373	2,097,397
Construction	11,101	185	11,286	5,177	233	5,410
Total residential mortgages	2,262,047	247,277	2,509,324	1,813,201	289,606	2,102,807
Consumer loans:						
Home equity	294,261	94,243	388,504	294,954	115,227	410,181
Auto and other	651,429	81,255	732,684	603,767	113,902	717,669
Total consumer loans	945,690	175,498	1,121,188	898,721	229,129	1,127,850
Total loans	\$7,070,475	\$1,834,038	\$8,904,513	\$6,112,198	\$2,187,140	\$8,299,338

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The carrying amount of the acquired loans at September 30, 2018 totaled \$1.8 billion. A subset of these loans was determined to have evidence of credit deterioration at acquisition date, which is accounted for in accordance with ASC 310-30. These purchased credit-impaired loans presently maintain a carrying value of \$63.2 million (and a note balance of \$153.9 million). These loans are evaluated for impairment through the periodic reforecasting of expected cash flows. Loans considered not credit-impaired at acquisition date had a carrying amount of \$1.8 billion.

At December 31, 2017, acquired loans maintained a carrying value of \$2.2 billion and purchased credit-impaired loans totaled \$97.3 million (note balance of \$208.7 million). Loans considered not credit-impaired at acquisition date had a carrying amount of \$2.1 billion.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality:

	Three Months Ended September 30,	
(In thousands)	2018	2017
Balance at beginning of period	\$6,304	\$5,767
Accretion	(1,702 )	(872 )
Net reclassifications from (to) nonaccretable difference	564	10
Payments received, net	(543 )	(841 )
Disposals	—	—
Balance at end of period	\$4,623	\$4,064

  

	Nine Months Ended September 30,	
(In thousands)	2018	2017
Balance at beginning of period	\$11,561	\$8,738
Accretion	(6,620 )	(2,923 )
Net reclassifications from (to) nonaccretable difference	2,218	343
Payments received, net	(2,455 )	(2,094 )
Disposals	(81 )	—
Balance at end of period	\$4,623	\$4,064

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of past due loans at September 30, 2018 and December 31, 2017:

## Business Activities Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
September 30, 2018							
Commercial real estate:							
Construction	\$ —	\$ —	\$—	\$ —	\$321,842	\$321,842	\$ —
Other commercial real estate	8,222	395	19,872	28,489	2,089,550	2,118,039	723
Total	8,222	395	19,872	28,489	2,411,392	2,439,881	723
Commercial and industrial loans:							
Total	6,843	873	3,472	11,188	1,411,669	1,422,857	10
Residential mortgages:							
1-4 family	1,919	231	1,829	3,979	2,246,967	2,250,946	339
Construction	—	—	—	—	11,101	11,101	—
Total	1,919	231	1,829	3,979	2,258,068	2,262,047	339
Consumer loans:							
Home equity	154	25	1,570	1,749	292,512	294,261	—
Auto and other	2,962	548	1,646	5,156	646,273	651,429	49
Total	3,116	573	3,216	6,905	938,785	945,690	49
Total	\$ 20,100	\$ 2,072	\$28,389	\$ 50,561	\$ 7,019,914	\$ 7,070,475	\$ 1,121

## Business Activities Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2017							
Commercial real estate:							
Construction	\$ —	\$ —	\$—	\$ —	\$269,206	\$269,206	\$ —
Other commercial real estate	1,925	48	5,474	7,447	1,941,054	1,948,501	457
Total	1,925	48	5,474	7,447	2,210,260	2,217,707	457
Commercial and industrial loans:							
Total	4,031	1,912	6,023	11,966	1,170,603	1,182,569	128
Residential mortgages:							
1-4 family	2,412	242	2,186	4,840	1,803,184	1,808,024	520
Construction	—	—	—	—	5,177	5,177	—
Total	2,412	242	2,186	4,840	1,808,361	1,813,201	520
Consumer loans:							
Home equity	444	1,235	1,747	3,426	291,528	294,954	120
Auto and other	3,389	599	1,597	5,585	598,182	603,767	143
Total	3,833	1,834	3,344	9,011	889,710	898,721	263
Total	\$ 12,201	\$ 4,036	\$17,027	\$ 33,264	\$ 6,078,934	\$ 6,112,198	\$ 1,368



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Acquired Credit Impaired	Total Loans	Past Due > 90 days and Accruing
September 30, 2018							
Commercial real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ 7,535	\$ 52,946	\$ —
Other commercial real estate	1,820	1,690	3,559	7,069	16,875	878,946	70
Total	1,820	1,690	3,559	7,069	24,410	931,892	70
Commercial and industrial loans:							
Total	1,260	243	1,452	2,956	31,372	479,371	—
Residential mortgages:							
1-4 family	781	107	1,192	2,080	5,049	247,092	—
Construction	—	—	—	—	—	185	—
Total	781	107	1,192	2,080	5,049	247,277	—
Consumer loans:							
Home equity	350	5	736	1,091	2,010	94,243	—
Auto and other	245	98	513	856	336	81,255	14
Total	595	103	1,249	1,947	2,346	175,498	14
Total	\$ 4,456	\$ 2,143	\$ 7,452	\$ 14,052	\$ 63,177	\$ 1,834,038	\$ 84

## Acquired Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Acquired Credit Impaired	Total Loans	Past Due > 90 days and Accruing
December 31, 2017							
Commercial real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ 7,655	\$ 84,965	\$ —
Other commercial real estate	1,487	1,875	2,359	5,721	45,647	962,070	109
Total	1,487	1,875	2,359	5,721	53,302	1,047,035	109
Commercial and industrial loans:							
Total	1,252	268	1,439	2,959	34,629	621,370	23
Residential mortgages:							
1-4 family	957	2,581	1,247	4,785	6,974	289,373	30
Construction	—	—	—	—	—	233	—
Total	957	2,581	1,247	4,785	6,974	289,606	30
Consumer loans:							
Home equity	286	40	1,965	2,291	1,956	115,227	—
Auto and other	346	135	430	911	483	113,902	38
Total	632	175	2,395	3,202	2,439	229,129	38
Total	\$ 4,328	\$ 4,899	\$ 7,440	\$ 16,667	\$ 97,344	\$ 2,187,140	\$ 200



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is summary information pertaining to non-accrual loans at September 30, 2018 and December 31, 2017:

(In thousands)	September 30, 2018			December 31, 2017		
	Business Acquired Activities <del>Loans</del> (1)	Loans(1)	Total	Business Acquired Activities <del>Loans</del> (2)	Loans(2)	Total
Commercial real estate:						
Construction	\$—	\$—	\$—	\$—	\$—	\$—
Other commercial real estate	19,149	3,415	22,564	5,017	2,250	7,267
Total	19,149	3,415	22,564	5,017	2,250	7,267
Commercial and industrial loans:						
Total	3,462	1,452	4,914	5,895	1,333	7,228
Residential mortgages:						
1-4 family	1,490	1,192	2,682	1,666	1,217	2,883
Construction	—	—	—	—	—	—
Total	1,490	1,192	2,682	1,666	1,217	2,883
Consumer loans:						
Home equity	1,570	736	2,306	1,627	1,965	3,592
Auto and other	1,597	499	2,096	1,454	392	1,846
Total	3,167	1,235	4,402	3,081	2,357	5,438
Total non-accrual loans	\$27,268	\$ 7,294	\$34,562	\$15,659	\$ 7,157	\$22,816

(1) At quarter end September 30, 2018, acquired credit impaired loans accounted for \$74 thousand of loans greater than 90 days past due that are not presented in the above table.

(2) At December 31, 2017, acquired credit impaired loans accounted for \$83 thousand of loans greater than 90 days past due that are not presented in the above table.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Loans evaluated for impairment as of September 30, 2018 and December 31, 2017 were as follows:

## Business Activities Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
September 30, 2018					
Loans receivable:					
Balance at end of period					
Individually evaluated for impairment	\$ 24,556	\$ 2,314	\$ 1,921	\$ 971	\$ 29,762
Collectively evaluated for impairment	2,415,325	1,420,543	2,260,126	944,719	7,040,713
Total	\$ 2,439,881	\$ 1,422,857	\$ 2,262,047	\$ 945,690	\$ 7,070,475

## Business Activities Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
December 31, 2017					
Loans receivable:					
Balance at end of year					
Individually evaluated for impairment	\$ 33,732	\$ 5,761	\$ 3,872	\$ —	\$ 43,365
Collectively evaluated for impairment	2,183,975	1,176,808	1,809,329	898,721	6,068,833
Total	\$ 2,217,707	\$ 1,182,569	\$ 1,813,201	\$ 898,721	\$ 6,112,198

## Acquired Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
September 30, 2018					
Loans receivable:					
Balance at end of Period					
Individually evaluated for impairment	\$ 5,005	\$ 823	\$ 648	\$ 509	\$ 6,985
Purchased credit-impaired loans	24,410	31,372	5,049	2,346	63,177
Collectively evaluated for impairment	902,477	447,176	241,580	172,643	1,763,876
Total	\$ 931,892	\$ 479,371	\$ 247,277	\$ 175,498	\$ 1,834,038

## Acquired Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
December 31, 2017					
Loans receivable:					
Balance at end of year					
Individually evaluated for impairment	\$ 4,244	\$ 421	\$ 2,617	\$ 27	\$ 7,309
Purchased credit-impaired loans	53,302	34,629	6,974	2,439	97,344
Collectively evaluated for impairment	989,489	586,320	280,015	226,663	2,082,487
Total	\$ 1,047,035	\$ 621,370	\$ 289,606	\$ 229,129	\$ 2,187,140



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of impaired loans at September 30, 2018 and December 31, 2017:

## Business Activities Loans

(In thousands)	September 30, 2018		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Other commercial real estate loans	\$25,225	\$ 31,064	\$ —
Commercial and industrial loans	1,222	4,947	—
Residential mortgages - 1-4 family	698	810	—
Consumer - home equity	917	1,602	—
Consumer - other	—	—	—
With an allowance recorded:			
Other commercial real estate loans	\$1,397	\$ 1,393	\$ 16
Commercial and industrial loans	1,311	1,294	58
Residential mortgages - 1-4 family	1,379	1,424	106
Consumer - home equity	41	50	—
Consumer - other	14	14	1
Total			
Commercial real estate	\$26,622	\$ 32,457	\$ 16
Commercial and industrial loans	2,533	6,241	58
Residential mortgages	2,077	2,234	106
Consumer	972	1,666	1
Total impaired loans	\$32,204	\$ 42,598	\$ 181

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. These amounts are components of total loans and other assets on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Business Activities Loans

(In thousands)	December 31, 2017		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Other commercial real estate loans	\$19,362	\$ 22,218	\$ —
Commercial and industrial loans	2,060	2,629	—
Residential mortgages - 1-4 family	660	1,075	—
Consumer - home equity	867	1,504	—
With an allowance recorded:			
Commercial real estate - construction	\$159	\$ 159	\$ 1
Other commercial real estate loans	14,480	15,406	228
Commercial and industrial loans	3,716	4,249	66
Residential mortgages - 1-4 family	1,344	1,446	130
Consumer - home equity	1,014	999	34
Consumer - other	17	17	1
Total			
Commercial real estate	\$34,001	\$ 37,783	\$ 229
Commercial and industrial loans	5,776	6,878	66
Residential mortgages	2,004	2,521	130
Consumer	1,898	2,520	35
Total impaired loans	\$43,679	\$ 49,702	\$ 460

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. This amount is a component of total loans on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	September 30, 2018		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Other commercial real estate loans	\$4,428	\$ 7,361	\$ —
Commercial and industrial loans	652	742	—
Residential mortgages - 1-4 family	547	585	—
Consumer - home equity	485	1,172	—
Consumer - other	13	15	—
With an allowance recorded:			
Other commercial real estate loans	\$1,202	\$ 1,219	\$ 15
Commercial and industrial loans	326	325	6
Residential mortgages - 1-4 family	106	127	9
Consumer - home equity	146	146	3
Total			x
Commercial real estate	\$5,630	\$ 8,580	\$ 15
Commercial and industrial loans	978	1,067	6
Residential mortgages	653	712	9
Consumer	644	1,333	3
Total impaired loans	\$7,905	\$ 11,692	\$ 33

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. This amount is a component of total loans on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	December 31, 2017		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Other commercial real estate loans	\$1,327	\$ 3,084	\$ —
Other commercial and industrial loans	255	310	—
Residential mortgages - 1-4 family	658	671	—
Consumer - home equity	1,374	1,654	—
Consumer - other	27	27	—
With an allowance recorded:			
Other commercial real estate loans	\$2,930	\$ 2,541	\$ 56
Commercial and industrial loans	165	166	1
Residential mortgages - 1-4 family	166	185	9
Consumer - home equity	433	540	45
Total			
Commercial real estate	\$4,257	\$ 5,625	\$ 56
Commercial and industrial loans	420	476	1
Residential mortgages	824	856	9
Consumer	1,834	2,221	45
Total impaired loans	\$7,335	\$ 9,178	\$ 111

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. This amount is a component of total loans on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of the average recorded investment and interest income recognized on impaired loans as of September 30, 2018 and 2017:

## Business Activities Loans

(In thousands)	Nine Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Other commercial real estate loans	\$24,277	\$ 277	\$21,216	\$ 934
Commercial and industrial loans	2,451	343	1,825	69
Residential mortgages - 1-4 family	683	22	1,391	29
Consumer - home equity	797	10	1,301	26
Consumer - other	—	—	—	—
With an allowance recorded:				
Other commercial real estate loans	\$1,415	\$ 60	\$10,725	\$ 373
Commercial and industrial loans	1,395	111	6,493	354
Residential mortgages - 1-4 family	1,401	47	1,187	38
Consumer - home equity	44	2	1,094	32
Consumer - other	15	1	—	—
Total				
Commercial real estate	\$25,692	\$ 337	\$31,941	\$ 1,307
Commercial and industrial loans	3,846	454	8,318	423
Residential mortgages	2,084	69	2,578	67
Consumer loans	856	13	2,395	58
Total impaired loans	\$32,478	\$ 873	\$45,232	\$ 1,855

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	Nine Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Other commercial real estate loans	\$4,354	\$ 212	\$907	\$ 152
Commercial and industrial loans	552	40	319	4
Residential mortgages - 1-4 family	572	6	170	7
Consumer - home equity	766	2	567	—
Consumer - other	16	1	—	—
With an allowance recorded:				
Other commercial real estate loans	\$1,225	\$ 53	\$2,385	\$ 92
Commercial and industrial loans	202	32	332	29
Residential mortgages - 1-4 family	80	6	319	12
Consumer - home equity	148	4	387	13
Consumer - other	—	—	—	—
Total				
Other commercial real estate loans	\$5,579	\$ 265	\$3,292	\$ 244
Commercial and industrial loans	754	72	651	33
Residential mortgages	652	12	489	19
Consumer loans	930	7	954	13
Total impaired loans	\$7,915	\$ 356	\$5,386	\$ 309

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Troubled Debt Restructuring Loans

The Company's loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. TDRs are evaluated individually for impairment and may result in a specific allowance amount allocated to an individual loan.

The following tables include the recorded investment and number of modifications identified during the three and nine months ended September 30, 2018. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. The modifications for the three months ended September 30, 2018 were attributable to interest rate concessions and modified payment terms. The modifications for the nine months ended September 30, 2018 were attributable to interest rate concessions, principal concessions, maturity date extensions, modified payment terms, reamortization, and accelerated maturity. The modifications for the three months ended September 30, 2017 were attributable to interest rate concessions, principal concessions, maturity date extensions, modified payment terms, reamortization, and accelerated maturity. The modifications for the nine months ended September 30, 2017 were attributable to interest rate concessions, principal concessions, maturity date extensions, modified payment terms, reamortization, and accelerated maturity.

(Dollars in thousands)	Three Months Ended September 30, 2018			
	Pre-Modification		Post-Modification	
	Number of	Outstanding Recorded	Outstanding Recorded	Investment
	Modifications	Investment	Investment	
Troubled Debt Restructurings				
Commercial and industrial	—	\$ —	\$ —	—
Residential - 1-4 Family	1	30	30	
Total	1	\$ 30	\$ 30	
Nine Months Ended September 30, 2018				
(Dollars in thousands)	Pre-Modification		Post-Modification	
	Number of	Outstanding Recorded	Outstanding Recorded	Investment
	Modifications	Investment	Investment	
Troubled Debt Restructurings				
Commercial and industrial	4	\$ 1,995	\$ 1,924	
Residential - 1-4 Family	2	148	148	
Total	6	\$ 2,143	\$ 2,072	
Three Months Ended September 30, 2017				
(Dollars in thousands)	Pre-Modification		Post-Modification	
	Number of	Outstanding Recorded	Outstanding Recorded	Investment
	Modifications	Investment	Investment	
Troubled Debt Restructurings				
Commercial - Other	—	\$ —	\$ —	
Commercial and industrial - Other	3	1,654	1,654	
Residential - 1-4 Family	—	—	—	
Consumer Home Equity	—	—	—	
Total	3	\$ 1,654	\$ 1,654	





## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)	Nine Months Ended September 30, 2017	
	Pre-Modification Number of Outstanding Modifications Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings		
Commercial - Other	15 \$ 13,445	\$ 11,718
Commercial and industrial - Other	8 3,471	3,471
Residential - 1-4 Family	2 205	188
Consumer Home Equity	1 53	53
Total	26 \$ 17,174	\$ 15,430

The following table discloses the recorded investments and numbers of modifications for TDRs where a concession has been made within the previous 12 months, that then defaulted in the respective reporting period. For the three months ended September 30, 2018, there were no loans that were restructured that had subsequently defaulted during the period. For the nine months ended September 30, 2018, there were two loans that were restructured that had subsequently defaulted during the period.

(Dollars in thousands)	Modifications that Subsequently Defaulted Three Months Ended September 30, 2018	
	Number of Contracts	Recorded Investment
Troubled Debt Restructurings		
Commercial - Other	—	\$ —
Commercial and industrial - Other	—	\$ —

(Dollars in thousands)	Modifications that Subsequently Defaulted Nine Months Ended September 30, 2018	
	Number of Contracts	Recorded Investment
Troubled Debt Restructurings		
Commercial - Other	1	\$ 5,992
Commercial and industrial - Other	1	\$ 1,065

(Dollars in thousands)	Modifications that Subsequently Defaulted Three Months Ended September 30, 2017	
	Number of Contracts	Recorded Investment
Troubled Debt Restructurings		
Commercial - Other	—	\$ —
Commercial and industrial - Other	—	\$ —

(Dollars in thousands)	Modifications that Subsequently Defaulted Nine Months Ended September 30, 2017	
	Number of Contracts	Recorded Investment
Troubled Debt Restructurings		
Commercial - Other	1	\$ 113
Commercial and industrial - Other	1	\$ 101

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the Company's TDR activity for the three and nine months ended September 30, 2018 and 2017:

(In thousands)	Three Months Ended September 30,	
	2018	2017
Balance at beginning of the period	\$33,507	\$44,556
Principal payments	(3,567 )	(373 )
TDR status change (1)	—	—
Other reductions/increases (2)	(1,206 )	(1,939 )
Newly identified TDRs	30	1,654
Balance at end of the period	\$28,764	\$43,898
(In thousands)	Nine Months Ended September 30,	
	2018	2017
Balance at beginning of the period	\$41,990	\$33,829
Principal payments	(6,718 )	(1,527 )
TDR status change (1)	—	—
Other reductions/increases (2)	(8,580 )	(3,834 )
Newly identified TDRs	2,072	15,430
Balance at end of the period	\$28,764	\$43,898

(1) TDR status change classification represents TDR loans with a specified interest rate equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk and the loan was on current payment status and not impaired based on the terms specified by the restructuring agreement. (2) Other reductions classification consists of transfer to other real estate owned, payoffs, charge-offs and advances to loans.

The evaluation of certain loans individually for specific impairment includes loans that were previously classified as TDRs or continue to be classified as TDRs.

As of September 30, 2018, the Company maintained no foreclosed residential real estate property. Additionally, residential mortgage loans collateralized by real estate property that are in the process of foreclosure as of September 30, 2018 and December 31, 2017 totaled \$6.2 million and \$4.9 million, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 5. LOAN LOSS ALLOWANCE

Activity in the allowance for loan losses for the three and nine months ended September 30, 2018 and 2017 was as follows:

Business Activities Loans (In thousands)	At or for the three months ended September 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$ 19,151	\$ 14,655	\$ 9,430	\$ 7,078	\$ 50,314
Charged-off loans	2,964	174	35	728	3,901
Recoveries on charged-off loans	1	60	108	47	216
Provision/(releases) for loan losses	4,406	493	587	919	6,405
Balance at end of period	\$ 20,594	\$ 15,034	\$ 10,090	\$ 7,316	\$ 53,034
Business Activities Loans (In thousands)	At or for the nine months ended September 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$ 16,843	\$ 13,850	\$ 9,420	\$ 5,807	\$ 45,920
Charged-off loans	4,462	2,770	62	2,505	9,799
Recoveries on charged-off loans	50	551	114	256	971
Provision/(releases) for loan losses	8,163	3,403	618	3,758	15,942
Balance at end of period	\$ 20,594	\$ 15,034	\$ 10,090	\$ 7,316	\$ 53,034
Business Activities Loans (In thousands)	At or for the three months ended September 30, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$ 15,972	\$ 12,588	\$ 8,114	\$ 6,221	\$ 42,895
Charged-off loans	1,367	606	42	1,352	3,367
Recoveries on charged-off loans	14	37	241	39	331
Provision/(releases) for loan losses	1,210	1,952	241	1,473	4,876
Balance at end of period	\$ 15,829	\$ 13,971	\$ 8,554	\$ 6,381	\$ 44,735
Business Activities Loans (In thousands)	At or for the nine months ended September 30, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$ 16,499	\$ 9,446	\$ 7,800	\$ 5,484	\$ 39,229
Charged-off loans	2,883	2,457	555	2,670	8,565
Recoveries on charged-off loans	71	108	270	211	660
Provision/(releases) for loan losses	2,142	6,874	1,039	3,356	13,411
Balance at end of period	\$ 15,829	\$ 13,971	\$ 8,554	\$ 6,381	\$ 44,735

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	At or for the three months ended September 30, 2018				
Acquired Loans (In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$3,382	\$ 1,127	\$ 618	\$ 484	\$5,611
Charged-off loans	119	181	25	245	570
Recoveries on charged-off loans	9	104	14	32	159
Provision/(releases) for loan losses	115	(41 )	(15 )	164	223
Balance at end of period	\$3,387	\$ 1,009	\$ 592	\$ 435	\$5,423

	At or for the nine months ended September 30, 2018				
Acquired Loans (In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$3,856	\$ 1,125	\$ 598	\$ 335	\$5,914
Charged-off loans	1,831	336	1,078	938	4,183
Recoveries on charged-off loans	274	199	50	376	899
Provision/(releases) for loan losses	1,088	21	1,022	662	2,793
Balance at end of period	\$3,387	\$ 1,009	\$ 592	\$ 435	\$5,423

	At or for the three months ended September 30, 2017				
Acquired Loans (In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$2,356	\$ 1,014	\$ 690	\$ 404	\$4,464
Charged-off loans	95	153	70	111	429
Recoveries on charged-off loans	22	150	1	37	210
Provision/(releases) for loan losses	109	(149 )	49	15	24
Balance at end of period	\$2,392	\$ 862	\$ 670	\$ 345	\$4,269

	At or for the nine months ended September 30, 2017				
Acquired Loans (In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$2,303	\$ 1,164	\$ 766	\$ 536	\$4,769
Charged-off loans	765	634	285	601	2,285
Recoveries on charged-off loans	44	151	39	78	312
Provision/(releases) for loan losses	810	181	150	332	1,473
Balance at end of period	\$2,392	\$ 862	\$ 670	\$ 345	\$4,269



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present a summary of the allowance for loan losses as of September 30, 2018 and December 31, 2017:

Business Activities Loans (In thousands)	At September 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	16	58	106	1	181
Collectively evaluated for impairment	20,578	14,976	9,984	7,315	52,853
Total	\$20,594	\$ 15,034	\$ 10,090	\$ 7,316	\$53,034

Business Activities Loans (In thousands)	At December 31, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	229	66	130	35	460
Collectively evaluated for impairment	16,614	13,784	9,290	5,772	45,460
Total	16,843	13,850	9,420	5,807	45,920

Acquired Loans (In thousands)	At September 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	15	6	9	3	33
Purchased credit-impaired loans	—	—	—	—	—
Collectively evaluated for impairment	3,372	1,003	583	432	5,390
Total	\$3,387	\$ 1,009	\$ 592	\$ 435	\$5,423

Acquired Loans (In thousands)	At December 31, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	56	1	9	45	111
Collectively evaluated for impairment	3,800	1,124	589	290	5,803
Total	3,856	1,125	598	335	5,914

## Credit Quality Information

## Business Activities Loans Credit Quality Analysis

The Company monitors the credit quality of its portfolio by using internal risk ratings that are based on regulatory guidance. Loans that are given a Pass rating are not considered a problem credit. Loans that are classified as Special Mention loans are considered to have potential credit problems and are evaluated closely by management.

Substandard and non-accruing loans are loans for which a definitive weakness has been identified and which may make full collection of contractual cash flows questionable. Doubtful loans are those with identified weaknesses that make full collection of contractual cash flows, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

For commercial credits, the Company assigns an internal risk rating at origination and reviews the rating annually, semiannually or quarterly depending on the risk rating. The rating is also reassessed at any point in time when

management becomes aware of information that may affect the borrower's ability to fulfill their obligations.

The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Loans that are current within 59 days are rated Pass. Residential mortgages that are 60-89 days delinquent are rated Special Mention. Loans delinquent for 90 days

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

or greater are rated Substandard and generally placed on non-accrual status. Home equity loans are risk rated based on the same rating system as the Company's residential mortgages.

Ratings for other consumer loans, including auto loans, are based on a two rating system. Loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Other consumer loans are placed on non-accrual at such time as they become Non-performing.

### Acquired Loans Credit Quality Analysis

Upon acquiring a loan portfolio, the Company's internal loan review function assigns risk ratings to the acquired loans, utilizing the same methodology as it does with business activities loans. This may differ from the risk rating policy of the predecessor bank. Loans which are rated Substandard or worse according to the rating process outlined below are deemed to be credit impaired loans accounted for under ASC 310-30, regardless of whether they are classified as performing or non-performing.

The Bank utilizes an eleven grade internal loan rating system for each of its acquired commercial real estate, construction and commercial loans as outlined in the Credit Quality Information section of this Note. The ratings system is similar to loans originated through business activities.

The Company subjects loans that do not meet the ASC 310-30 criteria to ASC 450-20 (Loss Contingencies) by collectively evaluating these loans for an allowance for loan loss. The Company applies a methodology similar to the methodology prescribed for business activities loans, which includes the application of environmental factors to each category of loans. The methodology to collectively evaluate the acquired loans outside the scope of ASC 310-30 includes the application of a number of environmental factors that reflect management's best estimate of the level of incremental credit losses that might be recognized given current conditions. This is reviewed as part of the allowance for loan loss adequacy analysis. As the loan portfolio matures and environmental factors change, the loan portfolio will be reassessed each quarter to determine an appropriate reserve allowance.

Additionally, the Company considers the need for a reserve for acquired loans accounted for outside of the scope of ASC 310-30 under ASC 310-20. At acquisition date, the Bank determined a fair value mark with credit and interest rate components. Under the Company's model, the impairment evaluation process involves comparing the carrying value of acquired loans, including the entire unamortized premium or discount, to the calculated reserve allowance. If necessary, the Company books a reserve to account for shortfalls identified through this calculation. Fair value marks are not bifurcated when evaluating for impairment.

A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time for ASC 310-30 loans. At September 30, 2018, the allowance for loan losses related to acquired loans under ASC 310-30 and ASC 310-20 was \$5.4 million using the above mentioned criteria.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present the Company's loans by risk rating at September 30, 2018 and December 31, 2017:

## Business Activities Loans

## Commercial Real Estate

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Real Estate		Total commercial real estate	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Grade:						
Pass	\$321,842	\$269,206	\$2,033,500	\$1,901,545	\$2,355,342	\$2,170,751
Special mention	—	—	31,635	13,503	31,635	13,503
Substandard	—	—	52,904	33,453	52,904	33,453
Total	\$321,842	\$269,206	\$2,118,039	\$1,948,501	\$2,439,881	\$2,217,707

## Commercial and Industrial Loans

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Total comm. and industrial loans	
	September 30, 2018	December 31, 2017
Grade:		
Pass	\$1,394,467	\$1,156,240
Special mention	11,077	12,806
Substandard	16,402	11,123
Doubtful	911	2,400
Total	\$1,422,857	\$1,182,569

## Residential Mortgages

## Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Grade:						
Pass	\$2,248,886	\$1,805,596	\$11,101	\$5,177	\$2,259,987	\$1,810,773
Special mention	231	242	—	—	231	242
Substandard	1,829	2,186	—	—	1,829	2,186
Total	\$2,250,946	\$1,808,024	\$11,101	\$5,177	\$2,262,047	\$1,813,201

## Consumer Loans

## Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Auto and other		Total consumer loans	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Performing	\$292,691	\$293,327	\$649,832	\$602,313	\$942,523	\$895,640
Nonperforming	1,570	1,627	1,597	1,454	3,167	3,081
Total	\$294,261	\$294,954	\$651,429	\$603,767	\$945,690	\$898,721



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

## Commercial Real Estate

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Real Estate		Total commercial real estate	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
	Grade:					
Pass	\$44,710	\$76,611	\$823,386	\$888,470	\$868,096	\$965,081
Special mention	—	—	9,311	22,673	9,311	22,673
Substandard	8,236	8,354	46,249	50,927	54,485	59,281
Total	\$52,946	\$84,965	\$878,946	\$962,070	\$931,892	\$1,047,035

## Commercial and Industrial Loans

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Total comm. and industrial loans	
	September 30, 2018	December 31, 2017
Grade:		
Pass	\$ 451,665	\$ 606,922
Special mention	11,601	1,241
Substandard	16,105	13,207
Total	\$ 479,371	\$ 621,370

## Residential Mortgages

## Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
	Grade:					
Pass	\$243,057	\$281,160	\$185	\$233	\$243,242	\$281,393
Special mention	107	2,704	—	—	107	2,704
Substandard	3,928	5,509	—	—	3,928	5,509
Total	\$247,092	\$289,373	\$185	\$233	\$247,277	\$289,606

## Consumer Loans

## Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Auto and other		Total consumer loans	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
	Performing	\$93,507	\$113,262	\$80,756	\$113,510	\$174,263
Nonperforming	736	1,965	499	392	1,235	2,357
Total	\$94,243	\$115,227	\$81,255	\$113,902	\$175,498	\$229,129



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about total loans rated Special Mention or lower as of September 30, 2018 and December 31, 2017. The table below includes consumer loans that are special mention and substandard accruing that are classified in the above table as performing based on payment activity.

(In thousands)	September 30, 2018			December 31, 2017		
	Business Activities	Acquired Loans	Total	Business Activities	Acquired Loans	Total
Non-Accrual	\$27,269	\$ 7,368	\$34,637	\$15,659	\$ 7,240	\$22,899
Substandard Accruing	47,994	68,673	116,667	36,846	73,412	110,258
Total Classified	75,263	76,041	151,304	52,505	80,652	133,157
Special Mention	43,517	21,125	64,642	28,387	26,802	55,189
Total Criticized	\$118,780	\$ 97,166	\$215,946	\$80,892	\$ 107,454	\$188,346

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 6. DEPOSITS

A summary of time deposits is as follows:

(In thousands)	September 30, 2018	December 31, 2017
Time less than \$100,000	\$ 707,328	\$ 733,785
Time \$100,000 through \$250,000	1,988,203	1,717,050
Time more than \$250,000	477,649	439,370
Total time deposits	\$ 3,173,180	\$ 2,890,205

Included in total deposits are brokered deposits of \$1.4 billion and \$1.1 billion at September 30, 2018 and December 31, 2017, respectively. Included in total deposits are reciprocal deposits of \$88.2 million and \$97.4 million at September 30, 2018 and December 31, 2017, respectively.

## NOTE 7. BORROWED FUNDS

Borrowed funds at September 30, 2018 and December 31, 2017 are summarized, as follows:

(Dollars in thousands)	September 30, 2018		December 31, 2017	
	Principal	Weighted Average Rate	Principal	Weighted Average Rate
Short-term borrowings:				
Advances from the FHLB	\$ 1,187,944	2.38 %	\$ 667,300	1.48 %
Total short-term borrowings:	1,187,944	2.38	667,300	1.48
Long-term borrowings:				
Advances from the FHLB and other borrowings	262,709	1.70	380,436	1.54
Subordinated borrowings	74,009	7.00	73,875	7.00
Junior subordinated borrowings	15,464	4.16	15,464	3.30
Total long-term borrowings:	352,182	2.92	469,775	2.46
Total	\$ 1,540,126	2.51 %	\$ 1,137,075	1.88 %

Short-term debt includes Federal Home Loan Bank (“FHLB”) advances with an original maturity of less than one year and a short-term line-of-credit drawdown through a correspondent bank. The Bank also maintains a \$3.0 million secured line of credit with the FHLB that bears a daily adjustable rate calculated by the FHLB. There was no outstanding balance on the FHLB line of credit for the periods ended September 30, 2018 and December 31, 2017.

The Bank is approved to borrow on a short-term basis from the Federal Reserve Bank of Boston as a non-member bank. The Bank has pledged certain loans and securities to the Federal Reserve Bank to support this arrangement. No borrowings with the Federal Reserve Bank took place for the periods ended September 30, 2018 and December 31, 2017.

Long-term FHLB advances consist of advances with an original maturity of more than one year. The advances outstanding at September 30, 2018 include no callable advances and amortizing advances totaling \$1.3 million. The advances outstanding at December 31, 2017 include no callable advances and amortizing advances totaling \$1.4 million. All FHLB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of maturities of FHLB advances as of September 30, 2018 is as follows:

(In thousands, except rates)	September 30, 2018	
	Principal	Weighted Average Rate
Fixed rate advances maturing:		
2018	\$ 1,240,944	2.34 %
2019	150,078	1.64
2020	53,003	2.04
2021	209	2.46
2022 and beyond	6,419	2.63
Total FHLB advances	\$ 1,450,653	2.26 %

The Company did not have variable-rate FHLB advances for the periods ended September 30, 2018 and December 31, 2017.

In September 2012, the Company issued fifteen year subordinated notes in the amount of \$75.0 million at a discount of 1.15%. The interest rate is fixed at 6.875% for the first ten years. After ten years, the notes become callable and convert to an interest rate of three-month LIBOR rate plus 5.113%. The subordinated note includes reduction to the note principal balance of \$491 thousand and \$583 thousand for unamortized debt issuance costs as of September 30, 2018 and December 31 2017, respectively.

The Company holds 100% of the common stock of Berkshire Hills Capital Trust I ("Trust I") which is included in other assets with a cost of \$0.5 million. The sole asset of Trust I is \$15.5 million of the Company's junior subordinated debentures due in 2035. These debentures bear interest at a variable rate equal to LIBOR plus 1.85% and had a rate of 4.16% and 3.30% at September 30, 2018 and December 31, 2017, respectively. The Company has the right to defer payments of interest for up to five years on the debentures at any time, or from time to time, with certain limitations, including a restriction on the payment of dividends to shareholders while such interest payments on the debentures have been deferred. The Company has not exercised this right to defer payments. The Company has the right to redeem the debentures at par value. Trust I is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, Trust I is not consolidated into the Company's financial statements.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 8. CAPITAL RATIOS AND SHAREHOLDERS' EQUITY

The actual and required capital ratios were as follows:

	September 30, 2018		Regulatory Minimum to be Well Capitalized		December 31, 2017		Regulatory Minimum to be Well Capitalized
Company (consolidated)							
Total capital to risk weighted assets	13.0	%	N/A		12.4	%	N/A
Common equity tier 1 capital to risk weighted assets	11.5		N/A		11.0		N/A
Tier 1 capital to risk weighted assets	11.6		N/A		11.2		N/A
Tier 1 capital to average assets	9.1		N/A		9.0		N/A
Bank							
Total capital to risk weighted assets	12.2	%	8.0	%	11.2	%	8.0
Common equity tier 1 capital to risk weighted assets	11.6		4.5		10.3		4.5
Tier 1 capital to risk weighted assets	11.6		6.0		10.3		6.0
Tier 1 capital to average assets	9.1		4.0		8.3		4.0

At each date shown, the Bank met the conditions to be classified as “well capitalized” under the relevant regulatory framework. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table above.

Effective January 1, 2015, the Company and the Bank became subject to the Basel III rule that requires the Company and the Bank to assess their Common equity Tier 1 capital to risk weighted assets. The Bank's Common equity Tier 1 capital to risk weighted assets exceeds the minimum to be well capitalized. In addition, the final capital rules added a requirement to maintain a minimum conservation buffer, composed of Common equity Tier 1 capital, of 2.5% of risk-weighted assets, to be phased in over three years and applied to the Common equity Tier 1 risk-based capital ratio, the Tier 1 risk-based capital ratio, and the Total risk-based capital ratio. Accordingly, banking organizations, on a fully phased in basis no later than January 1, 2019, must maintain a minimum Common equity Tier 1 risk-based capital ratio of 7.0%, a minimum Tier 1 risk-based capital ratio of 8.5%, and a minimum Total risk-based capital ratio of 10.5%.

The required minimum conservation buffer began to be phased in incrementally, starting at 0.625% on January 1, 2016, increased to 1.25% on January 1, 2017, increased to 1.875% on January 1, 2018 and will increase to 2.5% on January 1, 2019. The final capital rules impose restrictions on capital distributions and certain discretionary cash bonus payments if the minimum capital conservation buffer is not met.

At September 30, 2018, the capital levels of both the Company and the Bank exceeded all regulatory capital requirements and the Bank's regulatory capital ratios were above the minimum levels required to be considered well capitalized for regulatory purposes. The capital levels of both the Company and the Bank at September 30, 2018 also exceeded the minimum capital requirements including the currently applicable capital conservation buffer of 1.875%.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accumulated other comprehensive income (loss)

Components of accumulated other comprehensive income is as follows:

(In thousands)	September 30, 2018	December 31, 2017
Other accumulated comprehensive income, before tax:		
Net unrealized holding (loss)/gain on AFS securities	\$ (35,276 )	\$ 10,034
Net unrealized holding (loss) on pension plans	(3,048 )	(3,048 )
Income taxes related to items of accumulated other comprehensive income:		
Net unrealized holding loss/gain on AFS securities	8,874	(4,026 )
Net unrealized holding loss on pension plans	803	1,201
Accumulated other comprehensive (loss)/income	\$ (28,647 )	\$ 4,161

The following table presents the components of other comprehensive income for the three and nine months ended September 30, 2018 and 2017:

(In thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended September 30, 2018			
Net unrealized holding (loss) on AFS securities:	x		
Net unrealized (losses) arising during the period	\$ (9,923 )	\$ 2,546	\$ (7,377 )
Less: reclassification adjustment for gains realized in net income	6	(2 )	4
Net unrealized holding (loss) on AFS securities	(9,929 )	2,548	(7,381 )
Other comprehensive (loss)	\$ (9,929 )	\$ 2,548	\$ (7,381 )
Three Months Ended September 30, 2017			
Net unrealized holding gain on AFS securities:			
Net unrealized gains arising during the period	\$ 1,460	\$ (605 )	\$ 855
Less: reclassification adjustment for losses realized in net income	(1 )	—	(1 )
Net unrealized holding gain on AFS securities	1,461	(605 )	856
Other comprehensive income	\$ 1,461	\$ (605 )	\$ 856

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Before Tax	Tax Effect	Net of Tax
Nine Months Ended September 30, 2018			
Net unrealized holding (loss) on AFS securities:	x		
Net unrealized (losses) arising during the period	\$(36,925 )	\$ 9,478	\$(27,447 )
Less: reclassification adjustment for gains realized in net income	6	(2 )	\$ 4
Net unrealized holding (loss) on AFS securities	(36,931 )	9,480	\$(27,451 )
Other comprehensive (loss)	\$(36,931 )	\$ 9,480	\$(27,451 )
Less: reclassification related to adoption of ASU 2016-01	8,379	(2,126 )	6,253
Less: reclassification related to adoption of ASU 2018-02	—	(896 )	(896 )
Total change to accumulated other comprehensive (loss)	(45,310 )	12,502	(32,808 )
Nine Months Ended September 30, 2017			
Net unrealized holding gain on AFS securities:			
Net unrealized gains arising during the period	\$ 8,524	\$(3,232 )	\$ 5,292
Less: reclassification adjustment for gains realized in net income	12,568	(4,713 )	7,855
Net unrealized holding (loss) on AFS securities	(4,044 )	1,481	(2,563 )
Net unrealized loss on cash flow hedging derivatives:			
Net unrealized (loss) arising during the period	(449 )	180	(269 )
Less: reclassification adjustment for (losses) realized in net income	(7,022 )	2,769	(4,253 )
Net unrealized gain on cash flow hedging derivatives	6,573	(2,589 )	3,984
Other comprehensive income	\$ 2,529	\$(1,108 )	\$ 1,421

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the changes in each component of accumulated other comprehensive (loss) income, for the three and nine months ended September 30, 2018 and 2017:

(In thousands)	Net unrealized holding gain on AFS Securities	Net loss on effective cash flow hedging derivatives	Net unrealized holding loss on pension plans	Total
<b>Three Months Ended September 30, 2018</b>				
Balance at Beginning of Period	\$ (19,021 )	\$ —	\$ (2,245 )	\$ (21,266 )
Other comprehensive loss before reclassifications	(7,377 )	—	—	(7,377 )
Less: amounts reclassified from accumulated other comprehensive income (loss)	4	—	—	4
Total other comprehensive (loss)	(7,381 )	—	—	(7,381 )
Balance at End of Period	\$ (26,402 )	\$ —	\$ (2,245 )	\$ (28,647 )
<b>Three Months Ended September 30, 2017</b>				
Balance at Beginning of Period	\$ 12,121	\$ —	\$ (1,790 )	\$ 10,331
Other comprehensive gain before reclassifications	855	—	—	855
Less: amounts reclassified from accumulated other comprehensive income (loss)	(1 )	—	—	(1 )
Total other comprehensive income	856	—	—	856
Balance at End of Period	\$ 12,977	\$ —	\$ (1,790 )	\$ 11,187
<b>Nine Months Ended September 30, 2018</b>				
Balance at Beginning of Period	\$ 6,008	\$ —	\$ (1,847 )	\$ 4,161
Other comprehensive (loss) before reclassifications	(27,447 )	—	—	(27,447 )
Less: amounts reclassified from accumulated other comprehensive income	4	—	—	4
Total other comprehensive (loss)	(27,451 )	—	—	(27,451 )
Less: amounts reclassified from accumulated other comprehensive income (loss) related to adoption of ASU 2016-01 and ASU 2018-02	\$ 4,959	\$ —	\$ 398	\$ 5,357
Balance at End of Period	\$ (26,402 )	\$ —	\$ (2,245 )	\$ (28,647 )
<b>Nine Months Ended September 30, 2017</b>				
Balance at Beginning of Period	\$ 15,540	\$ (3,984 )	\$ (1,790 )	\$ 9,766
Other comprehensive gain (loss) before reclassifications	5,292	(269 )	—	5,023
Less: amounts reclassified from accumulated other comprehensive income	7,855	(4,253 )	—	3,602
Total other comprehensive (loss) income	(2,563 )	3,984	—	1,421
Balance at End of Period	\$ 12,977	\$ —	\$ (1,790 )	\$ 11,187



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the amounts reclassified out of each component of accumulated other comprehensive (loss) income for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018		2017		Affected Line Item in the Statement where Net Income is Presented
(In thousands)					
Realized gains on AFS securities:	\$ 6	\$ (1 )			Non-interest income
	(2 )	—			Tax expense
	4	(1 )			Net of tax
Realized (losses) on cash flow hedging derivatives:	—	—			Interest expense
	—	—			Non-interest expense
	—	—			Tax benefit
	—	—			Net of tax
Total reclassifications for the period	\$ 4	\$ (1 )			Net of tax
			Affected Line Item in the		
	Nine Months Ended September 30, 2018		2017		Statement where Net Income is Presented
(In thousands)					
Realized gains on AFS securities:	\$ 6	\$ 12,568			Non-interest income
	(2 )	(4,713 )			Tax expense
	4	7,855			Net of tax
Realized (losses) on cash flow hedging derivatives:	—	(393 )			Interest expense
	—	(6,629 )			Non-interest expense
	—	2,769			Tax benefit
	—	(4,253 )			Net of tax
Total reclassifications for the period	\$ 4	\$ 3,602			Net of tax

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 9. EARNINGS PER SHARE

Earnings per share have been computed based on the following (average diluted shares outstanding are calculated using the treasury stock method):

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
(In thousands, except per share data)	2018	2017	2018	2017
Net income	\$32,227	\$22,903	\$91,506	\$58,057
Average number of common shares issued	46,212	41,370	46,212	38,958
Less: average number of treasury shares	790	947	816	970
Less: average number of unvested stock award shares	435	439	430	441
Plus: average participating preferred shares	1,043	—	1,043	—
Average number of basic shares outstanding	46,030	39,984	46,009	37,547
Plus: dilutive effect of unvested stock award shares	202	116	186	116
Plus: dilutive effect of stock options outstanding	31	45	31	45
Average number of diluted shares outstanding	46,263	40,145	46,226	37,708
Earnings per common share:				
Basic	\$0.70	\$0.57	\$1.99	\$1.55
Diluted	\$0.70	\$0.57	\$1.98	\$1.54

For the nine months ended September 30, 2018, 245 thousand shares of restricted stock and 25 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the nine months ended September 30, 2017, 325 thousand shares of restricted stock and 46 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 10. STOCK-BASED COMPENSATION PLANS

A combined summary of activity in the Company's stock award and stock option plans for the nine months ended September 30, 2018 is presented in the following table:

(Shares in thousands)	Non-Vested Stock Awards Outstanding		Stock Options Outstanding	
	Number of Shares	Weighted-Average Grant Date Fair Value	Number of Shares	Weighted-Average Exercise Price
December 31, 2017	418	\$ 29.68	76	\$ 13.59
Granted	185	37.87	—	—
Stock options exercised	—	—	(8 )	12.46
Stock awards vested	(153 )	28.65	—	—
Forfeited	(18 )	33.79	—	—
Expired	—	—	(11 )	22.61
September 30, 2018	432	\$ 33.45	57	\$ 10.61
Exercisable options at September 30, 2018			57	\$ 10.61

There were no options exercised during the three months ended September 30, 2018. During the nine months ended September 30, 2018 proceeds from stock option exercises totaled \$101 thousand. During the three and nine months ended September 30, 2017, proceeds from stock option exercises totaled \$50 thousand and \$161 thousand, respectively. During the three and nine months ended September 30, 2018, there were 3 thousand and 153 thousand shares issued in connection with vested stock awards, respectively. During the three and nine months ended September 30, 2017, there were 28 thousand and 162 thousand shares issued in connection with vested stock awards, respectively. All of these shares were issued from available treasury stock. Stock-based compensation expense totaled \$1.5 million and \$1.3 million during the three months ended September 30, 2018 and 2017, respectively. Stock-based compensation expense totaled \$4.3 million and \$3.9 million during the nine months ended September 30, 2018 and 2017, respectively. Stock-based compensation expense is recognized over the requisite service period for all awards.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 11. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

As of September 30, 2018, the Company held derivatives with a total notional amount of \$3.1 billion. The Company had economic hedges and non-hedging derivatives totaling \$2.8 billion and \$0.2 billion, respectively, which are not designated as hedges for accounting purposes with changes in fair value recorded directly through earnings. Economic hedges included interest rate swaps totaling \$2.4 billion, risk participation agreements with dealer banks of \$0.2 billion, and \$0.2 billion in forward commitment contracts.

As part of the Company's risk management strategy, the Company enters into interest rate swap agreements to mitigate the interest rate risk inherent in certain of the Company's assets and liabilities. Interest rate swap agreements involve the risk of dealing with both Bank customers and institutional derivative counterparties and their ability to meet contractual terms. The agreements are entered into with counterparties that meet established credit standards and contain master netting and collateral provisions protecting the at-risk party. The derivatives program is overseen by the Risk Management and Capital Committee of the Company's Board of Directors. Based on adherence to the Company's credit standards and the presence of the netting and collateral provisions, the Company believes that the credit risk inherent in these contracts was not significant at September 30, 2018.

The Company pledged collateral to derivative counterparties in the form of cash totaling \$7.6 million and securities with an amortized cost of \$13.8 million and a fair value of \$13.3 million as of September 30, 2018. The Company does not typically require its commercial customers to post cash or securities as collateral on its program of back-to-back economic hedges. However certain language is written into the International Swaps Dealers Association, Inc. ("ISDA") and loan documents where, in default situations, the Bank is allowed to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Company may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions.

Information about derivative assets and liabilities at September 30, 2018, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
<b>Cash flow hedges:</b>					
Interest rate swaps on FHLB borrowings	\$ —	0	— %	— %	\$ —
Total cash flow hedges	—				—
<b>Economic hedges:</b>					
Interest rate swap on tax advantaged economic development bond	10,260	11.2	2.47 %	5.09 %	(1,033 )
Interest rate swaps on loans with commercial loan customers	1,190,469	6.3	3.93 %	4.46 %	21,465
Reverse interest rate swaps on loans with commercial loan customers	1,190,469	6.3	4.46 %	3.93 %	(21,065 )
Risk participation agreements with dealer banks	202,291	7.5			64
Forward sale commitments	235,152	0.2			587
Total economic hedges	2,828,641				18
<b>Non-hedging derivatives:</b>					
Commitments to lend	221,868	0.2			4,924
Total non-hedging derivatives	221,868				4,924

Total	\$ 3,050,509	\$ 4,942
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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Information about derivative assets and liabilities at December 31, 2017, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Received	Average Rate Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLB borrowings	\$ —	0	— %	— %	\$ —
Total cash flow hedges	—				—
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	10,755	11.9	1.73 %	5.09 %	(1,649 )
Interest rate swaps on loans with commercial loan customers	943,795	5.9	3.26 %	4.25 %	(3,195 )
Reverse interest rate swaps on loans with commercial loan customers	943,795	5.9	4.25 %	3.26 %	3,204
Risk participation agreements with dealer banks	142,054	8.4			(26 )
Forward sale commitments	276,572	0.2			(123 )
Total economic hedges	2,316,971				(1,789 )
Non-hedging derivatives:					
Commitments to lend	193,966	0.2			5,259
Total non-hedging derivatives	193,966				5,259
Total	\$ 2,510,937				\$ 3,470

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Cash flow hedges

In the first quarter of 2017, the Company maintained six interest rate swap contracts with an aggregate notional value of \$300 million with original durations of three years. This hedge strategy converted one month rolling FHLB borrowings based on the FHLB's one month fixed interest rate to fixed interest rates, thereby protecting the Company from floating interest rate variability.

On February 7, 2017, the Company initiated and subsequently terminated all of its interest rate swaps associated with FHLB advances with 1-month LIBOR based floating interest rates of an aggregate notional amount of \$300 million. As of March 31, 2017, the Company no longer held the FHLB advances associated with the interest rate swaps. As a result, the Company reclassified \$6.6 million of losses from the effective portion of the unrealized changes in the fair value of the terminated derivatives from other comprehensive income to non-interest income as the forecasted transactions to the related FHLB advances will not occur.

For the periods presented prior to the termination, the effective portion of unrealized changes in the fair value of derivatives accounted for as cash flow hedges was reported in other comprehensive income. Each quarter, the Company assessed the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or transaction. Hedge ineffectiveness on interest rate swaps designated as cash flow hedges was immaterial to the Company's financial statements during the three and nine months ended September 30, 2017.

Amounts included in the Consolidated Statements of Income and in the other comprehensive income section of the Consolidated Statements of Comprehensive Income (related to interest rate derivatives designated as hedges of cash flows), were as follows:

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2017
(In thousands)		
Interest rate swaps on FHLB borrowings:		
Unrealized (loss) recognized in accumulated other comprehensive loss	\$ —	\$ —(449 )
Less: reclassification of unrealized (loss) from accumulated other comprehensive income to interest expense	—	—(393 )
Less: reclassification of unrealized (loss) from accumulated other comprehensive income to other non-interest expense	—	—(6,629 )
Net tax (expense) benefit on items recognized in accumulated other comprehensive income	—	—(2,589 )
Other comprehensive gain (loss) recorded in accumulated other comprehensive income, net of reclassification adjustments and tax effects	\$ —	\$ —\$3,984

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Economic hedges

As of September 30, 2018, the Company has an interest rate swap with a \$10.3 million notional amount to swap out the fixed rate of interest on an economic development bond bearing a fixed rate of 5.09%, currently within the Company's trading portfolio under the fair value option, in exchange for a LIBOR-based floating rate. The intent of the economic hedge is to improve the Company's asset sensitivity to changing interest rates in anticipation of favorable average floating rates of interest over the 21-year life of the bond. The fair value changes of the economic development bond are mostly offset by fair value changes of the related interest rate swap.

The Company also offers certain derivative products directly to qualified commercial borrowers. The Company economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third-party financial institutions. The transaction allows the Company's customer to convert a variable-rate loan to a fixed rate loan. Because the Company acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts mostly offset each other in earnings. Credit valuation adjustments arising from the difference in credit worthiness of the commercial loan and financial institution counterparties totaled \$391 thousand as of September 30, 2018. The interest income and expense on these mirror image swaps exactly offset each other.

The Company has risk participation agreements with dealer banks. Risk participation agreements occur when the Company participates on a loan and a swap where another bank is the lead. The Company gets paid a fee to take on the risk associated with having to make the lead bank whole on Berkshire's portion of the pro-rated swap should the borrower default. Changes in fair value are recorded in current period earnings.

The Company utilizes forward sale commitments to hedge interest rate risk and the associated effects on the fair value of interest rate lock commitments and loans originated for sale. The forward sale commitments are accounted for as derivatives with changes in fair value recorded in current period earnings.

The Company uses the following types of forward sale commitments contracts:

- Best efforts loan sales,
- Mandatory delivery loan sales, and
- To Be Announced ("TBA") mortgage-backed securities sales.

A best efforts contract refers to a loan sale agreement where the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. The Company may enter into a best efforts contract once the price is known, which is shortly after the potential borrower's interest rate is locked.

A mandatory delivery contract is a loan sale agreement where the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. Generally, the Company may enter into mandatory delivery contracts shortly after the loan closes with a customer.

The Company may sell TBA mortgage-backed securities to hedge the changes in fair value of interest rate lock commitments and held for sale loans, which do not have corresponding best efforts or mandatory delivery contracts. These security sales transactions are closed once mandatory contracts are written. On the closing date the price of the security is locked-in, and the sale is paired-off with a purchase of the same security. Settlement of the security purchase/sale transaction is done with cash on a net-basis.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Non-hedging derivatives

The Company enters into interest rate lock commitments (“IRLCs”) for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance. Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. The IRLCs are free-standing derivatives which are carried at fair value with changes recorded in noninterest income in the Company’s consolidated statements of income. Changes in the fair value of IRLCs subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time.

Amounts included in the Consolidated Statements of Income related to economic hedges and non-hedging derivatives were as follows:

(In thousands)	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
<b>Economic hedges</b>				
<b>Interest rate swap on industrial revenue bond:</b>				
Unrealized gain recognized in other non-interest income	\$142	\$70	\$616	\$194
<b>Interest rate swaps on loans with commercial loan customers:</b>				
Unrealized gain/(loss) recognized in other non-interest income	4,721	(142 )	24,660	(1,824 )
<b>Reverse interest rate swaps on loans with commercial loan customers:</b>				
Unrealized gain/(loss) recognized in other non-interest income	(4,721 )	142	(24,660 )	1,824
Favorable (Unfavorable) change in credit valuation adjustment recognized in other non-interest income	60	(53 )	391	(329 )
<b>Risk participation agreements:</b>				
Unrealized gain recognized in other non-interest income	67	2	90	7
<b>Forward commitments:</b>				
Unrealized (loss) gain recognized in other non-interest income	587	500	(980 )	224
Realized gain (loss) in other non-interest income	115	(983 )	5,114	(3,651 )
<b>Non-hedging derivatives</b>				
<b>Commitments to lend</b>				
Unrealized gain recognized in other non-interest income	\$4,924	\$6,455	\$18,740	\$21,891
Realized gain in other non-interest income	3,345	7,402	6,439	23,869

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Assets and Liabilities Subject to Enforceable Master Netting Arrangements

## Interest Rate Swap Agreements ("Swap Agreements")

The Company enters into swap agreements to facilitate the risk management strategies for commercial banking customers. The Company mitigates this risk by entering into equal and offsetting swap agreements with highly rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated statements of condition. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral generally in the form of marketable securities is received or posted by the counterparty with net liability positions, respectively, in accordance with contract thresholds.

The Company had net asset positions with its financial institution counterparties totaling \$23.0 million and \$1.1 million as of September 30, 2018 and December 31, 2017, respectively. The Company had net asset positions with its commercial banking counterparties totaling \$4.1 million and \$8.6 million as of September 30, 2018 and December 31, 2017, respectively. The Company had net liability positions with its financial institution counterparties totaling \$2.5 million and \$5.9 million as of September 30, 2018 and December 31, 2017, respectively. The Company had net liability positions with its commercial banking counterparties totaling \$25.1 million and \$5.4 million as of September 30, 2018 and December 31, 2017. The collateral posted by the Company that covered liability positions was \$7.6 million and \$5.9 million as of September 30, 2018 and December 31, 2017, respectively.

The following table presents the assets and liabilities subject to an enforceable master netting arrangement as of September 30, 2018 and December 31, 2017:

## Offsetting of Financial Assets and Derivative Assets

(In thousands)	Gross Amounts of Assets Recognized	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Received	
September 30, 2018						
Interest Rate Swap Agreements:						
Institutional counterparties	\$ 23,886	\$ (901 )	\$ 22,985	\$ —	\$ —	\$ 22,985
Commercial counterparties	4,060	(9 )	4,051	—	—	4,051
Total	\$ 27,946	\$ (910 )	\$ 27,036	\$ —	\$ —	\$ 27,036

## Offsetting of Financial Liabilities and Derivative Liabilities

(In thousands)	Gross Amounts of Liabilities Recognized	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Pledged	
September 30, 2018						
Interest Rate Swap Agreements:						
Institutional counterparties	\$ (4,281 )	\$ 1,793	\$ (2,488 )	\$ —	\$ 7,569	\$ 5,081
Commercial counterparties	(25,194 )	78	(25,116 )	—	—	(25,116 )

Total                                    \$ (29,475 ) \$ 1,871                    \$ (27,604 ) \$ — \$ 7,569                                    \$ (20,035 )

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Offsetting of Financial Assets and Derivative Assets

(In thousands)	Gross Amounts of Recognized Assets	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Received	
December 31, 2017						
Interest Rate Swap Agreements:						
Institutional counterparties	\$ 2,692	\$ (1,622 )	\$ 1,070	\$ —	\$ —	\$ 1,070
Commercial counterparties	8,577	—	8,577	—	—	8,577
Total	\$ 11,269	\$ (1,622 )	\$ 9,647	\$ —	\$ —	\$ 9,647

## Offsetting of Financial Liabilities and Derivative Liabilities

(In thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Pledged	
December 31, 2017						
Interest Rate Swap Agreements:						
Institutional counterparties	\$(8,777 )	\$ 2,835	\$(5,942 )	\$ 3,982	\$ 1,960	\$ —
Commercial counterparties	(5,375 )	2	(5,373 )	—	—	(5,373 )
Total	\$(14,152 )	\$ 2,837	\$(11,315 )	\$ 3,982	\$ 1,960	\$ (5,373 )

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 12. FAIR VALUE MEASUREMENTS

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities that are carried at fair value.

## Recurring Fair Value Measurements

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

(In thousands)	September 30, 2018			
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading security	\$—	\$—	—\$11,179	\$ 11,179
Securities available for sale:				
Municipal bonds and obligations	—109,919	—	—	109,919
Agency collateralized mortgage obligations	—919,479	—	—	919,479
Agency residential mortgage-backed securities	—174,756	—	—	174,756
Agency commercial mortgage-backed securities	—58,664	—	—	58,664
Corporate bonds	—108,453	—	—	108,453
Trust preferred securities	—11,426	—	—	11,426
Other bonds and obligations	—8,676	—	—	8,676
Marketable equity securities	59,564	—	—	59,734
Loans held for sale	—91,639	—	—	91,639
Derivative assets	5829,716	4,924	—	35,227
Capitalized servicing rights	—	10,355	—	10,355
Derivative liabilities	—30,284	—	—	30,284
	December 31, 2017			
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
(In thousands)				
Trading security	\$—	\$—	—\$12,277	\$ 12,277
Securities available for sale:				
Municipal bonds and obligations	—118,233	—	—	118,233
Agency collateralized mortgage obligations	—851,158	—	—	851,158
Agency residential mortgage-backed securities	—216,940	—	—	216,940
Agency commercial mortgage-backed securities	—62,305	—	—	62,305
Corporate bonds	—110,721	—	—	110,721
Trust preferred securities	—11,677	—	—	11,677
Other bonds and obligations	—9,880	—	—	9,880
Marketable equity securities	44,354	—	—	45,185
Loans held for sale	—153,620	—	—	153,620
Derivative assets	—14,049	5,259	—	19,308
Capitalized servicing rights	—	3,834	—	3,834
Derivative liabilities	1045,715	19	—	15,838



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

There were no transfers between levels during the three or nine months ended September 30, 2018.

**Trading Security at Fair Value.** The Company holds one security designated as a trading security. It is a tax advantaged economic development bond issued to the Company by a local nonprofit which provides wellness and health programs. The determination of the fair value for this security is determined based on a discounted cash flow methodology. Certain inputs to the fair value calculation are unobservable and there is little to no market activity in the security; therefore, the security meets the definition of a Level 3 security. The discount rate used in the valuation of the security is sensitive to movements in the 3-month LIBOR rate.

**Securities Available for Sale and Marketable Equity Securities.** Marketable equity securities classified as Level 1 consist of publicly-traded equity securities for which the fair values can be obtained through quoted market prices in active exchange markets. AFS and marketable equity securities classified as Level 2 include most of the Company's debt securities. The pricing on Level 2 was primarily sourced from third party pricing services, overseen by management, and is based on models that consider standard input factors such as dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and condition, among other things.

September 30, 2018

(In thousands)	Fair Value	Amortized Cost	Gains
Marketable equity securities	\$ 59,734	\$ 55,545	\$ 4,189

December 31, 2017

(In thousands)	Fair Value	Amortized Cost	Gains
Marketable equity securities	\$ 45,185	\$ 36,483	\$ 8,702

**Loans Held for Sale.** The Company elected the fair value option for all loans held for sale (HFS) originated for sale on or after May 1, 2012. Loans HFS are classified as Level 2 as the fair value is based on input factors such as quoted prices for similar loans in active markets.

September 30, 2018	Aggregate	Aggregate	Aggregate Fair Value Less Aggregate
(In thousands)	Fair Value	Unpaid Principal	Unpaid Principal
Loans Held for Sale	\$ 91,639	\$ 89,560	\$ 2,079

December 31, 2017	Aggregate	Aggregate	Aggregate Fair Value Less Aggregate
(In thousands)	Fair Value	Unpaid Principal	Unpaid Principal
Loans Held for Sale	\$ 153,620	\$ 149,022	\$ 4,598

The changes in fair value of loans held for sale for the three and nine months ended September 30, 2018, were losses of \$1.4 million and \$2.5 million, respectively. The changes in fair value of loans held for sale for the three and nine months ended September 30, 2017, were losses of \$0.4 million and gains of \$2.0 million, respectively. The changes in fair value are included in mortgage banking originations in the Consolidated Statements of Income.

**Interest Rate Swaps.** The valuation of the Company's interest rate swaps is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and

interest rate curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings.

Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2018, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

**Commitments to Lend.** The Company enters into commitments to lend for residential mortgage loans intended for sale, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. The estimated fair value of commitments to originate residential mortgage loans for sale is based on quoted prices for similar loans in active markets. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close, and by the non-refundable costs of originating the loan. The closing ratio is derived from the Bank's internal data and is adjusted using significant management judgment. The costs to originate are primarily based on the Company's internal commission rates that are not observable. As such, these commitments are classified as Level 3 measurements.

**Forward Sale Commitments.** The Company utilizes forward sale commitments as economic hedges against potential changes in the values of the commitments to lend and loans originated for sale. To Be Announced ("TBA") mortgage-backed securities forward commitment sales are used as the hedging instrument, are classified as Level 1, and consist of publicly-traded debt securities for which identical fair values can be obtained through quoted market prices in active exchange markets. The fair values of the Company's best efforts and mandatory delivery loan sale commitments are determined similarly to the commitments to lend using quoted prices in the market place that are observable. However, costs to originate and closing ratios included in the calculation are internally generated and are based on management's judgment and prior experience, which are considered factors that are not observable. As such, best efforts and mandatory forward commitments are classified as Level 3 measurements.

**Capitalized Servicing Rights.** The Company accounts for certain capitalized servicing rights at fair value in its Consolidated Financial Statements, as the Company is permitted to elect the fair value option for each specific instrument. A loan servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans exceed adequate compensation for performing the servicing. The fair value of servicing rights is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation hierarchy. These capitalized servicing rights are included in other assets on the consolidated balance sheet.







## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Non-Recurring Fair Value Measurements

The Company is required, on a non-recurring basis, to adjust the carrying value or provide valuation allowances for certain assets using fair value measurements in accordance with GAAP. The following is a summary of applicable non-recurring fair value measurements. There are no liabilities measured at fair value on a non-recurring basis.

(In thousands)	September 30, 2018	December 31, 2017	Fair Value Measurement Date as of September 30, 2018
	Level 3 Inputs	Level 3 Inputs	Level 3 Inputs
Assets			
Impaired loans	\$ 5,707	\$ 23,853	September 2018
Capitalized servicing rights	12,358	12,527	September 2018
Total	\$ 18,065	\$ 36,380	

Quantitative information about the significant unobservable inputs within Level 3 non-recurring assets is as follows:

(In thousands)	Fair Value September 30, 2018	Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
Assets				
Impaired Loans	\$ 5,707	Fair Value of Collateral	Discounted Cash Flow - Loss Severity	38.17% to 0.24% (3.65%)
Capitalized servicing rights	12,358	Discounted Cash Flow	Appraised Value Constant Prepayment Rate (CPR)	\$3.80 to \$922.00 (\$460.70) 7.39% to 10.68% (9.74%)
Total	\$ 18,065		Discount Rate	10.00% to 16.12% (12.54%)

Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective (a) assets in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.

(In thousands)	Fair Value December 31, 2017	Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
Assets				
Impaired Loans	\$ 23,853	Fair Value of Collateral	Discounted Cash Flow - loss severity	38.72% to 0.21% (3.40%)
Capitalized servicing rights	12,527	Discounted Cash Flow	Appraised Value Constant Prepayment Rate (CPR)	\$10.90 to \$5,967.00 (\$2,197.00) 7.78% to 12.78% (10.38%)
Total	\$ 36,380		Discount Rate	10.00% to 13.28% (11.72%)

Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective (a) assets in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.

There were no Level 1 or Level 2 nonrecurring fair value measurements for the periods ended September 30, 2018 and December 31, 2017.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Impaired loans.** Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records non-recurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Non-recurring adjustments can also include certain impairment amounts for collateral-dependent loans calculated when establishing the allowance for credit losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated valuation amount does not necessarily represent the fair value of the loan. Real estate collateral is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. However, the choice of observable data is subject to significant judgment, and there are often adjustments based on judgment in order to make observable data comparable and to consider the impact of time, the condition of properties, interest rates, and other market factors on current values. Additionally, commercial real estate appraisals frequently involve discounting of projected cash flows, which relies inherently on unobservable data. Therefore, nonrecurring fair value measurement adjustments that relate to real estate collateral have generally been classified as Level 3. Estimates of fair value for other collateral that supports commercial loans are generally based on assumptions not observable in the marketplace and therefore such valuations have been classified as Level 3.

**Capitalized loan servicing rights.** A loan servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans exceed adequate compensation for performing the servicing. The fair value of servicing rights is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Adjustments are only recorded when the discounted cash flows derived from the valuation model are less than the carrying value of the asset. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation hierarchy.

**Other real estate owned (“OREO”).** OREO results from the foreclosure process on residential or commercial loans issued by the Bank. Upon assuming the real estate, the Company records the property at the fair value of the asset less the estimated sales costs. Thereafter, OREO properties are recorded at the lower of cost or fair value less the estimated sales costs. OREO fair values are primarily determined based on Level 3 data including comparable sales and appraisals.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Summary of Estimated Fair Values of Financial Instruments

The following tables summarize the estimated fair values, and related carrying amounts, of the Company's financial instruments. Certain financial instruments and all non-financial instruments are excluded. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

(In thousands)	September 30, 2018				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
<b>Financial Assets</b>					
Cash and cash equivalents	\$135,734	\$135,734	\$135,734	\$—	\$ —
Trading security	11,179	11,179	—	—	11,179
Marketable equity securities	59,734	59,734	59,171	563	—
Securities available for sale	1,391,373	1,391,373	—	1,391,373	—
Securities held to maturity	379,404	371,775	—	371,527	248
FHLB bank stock and restricted securities	76,184	N/A	N/A	N/A	N/A
Net loans	8,846,056	8,963,467	—	—	8,963,467
Loans held for sale	91,639	91,639	—	91,639	—
Accrued interest receivable	35,988	35,988	—	35,988	—
Cash surrender value of bank-owned life insurance policies	194,369	194,369	—	194,369	—
Derivative assets	35,227	35,227	587	29,716	4,924
Assets held for sale	1,070	1,070	—	1,070	—
<b>Financial Liabilities</b>					
Total deposits	\$8,766,101	\$8,732,410	\$—	\$8,732,410	\$ —
Short-term debt	1,187,944	1,187,890	—	1,187,890	—
Long-term Federal Home Loan Bank advances	262,709	260,703	—	260,703	—
Subordinated borrowings	89,473	97,040	—	97,040	—
Derivative liabilities	30,284	30,284	—	30,284	—

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	December 31, 2017				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
<b>Financial Assets</b>					
Cash and cash equivalents	\$248,763	\$248,763	\$248,763	\$—	\$ —
Trading security	12,277	12,277	—	—	12,277
Marketable equity securities	45,185	45,185	44,851	334	—
Securities available for sale and other	1,380,914	1,380,914	—	1,380,914	—
Securities held to maturity	397,103	405,276	—	371,458	33,818
FHLB bank stock and restricted securities	63,085	N/A	N/A	N/A	N/A
Net loans	8,247,504	8,422,034	—	—	8,422,034
Loans held for sale	153,620	153,620	—	153,620	—
Accrued interest receivable	33,739	33,739	—	33,739	—
Derivative assets	19,308	19,308	—	14,049	5,259
Assets held for sale	1,392	1,392	—	1,392	—
<b>Financial Liabilities</b>					
Total deposits	\$8,749,530	\$8,731,527	\$—	\$8,731,527	\$ —
Short-term debt	667,300	667,246	—	667,246	—
Long-term Federal Home Loan Bank advances	380,436	378,766	—	378,766	—
Subordinated borrowings	89,339	97,414	—	97,414	—
Derivative liabilities	15,838	15,838	104	15,715	19

Other than as discussed above, the following methods and assumptions were used by management to estimate the fair value of significant classes of financial instruments for which it is practicable to estimate that value.

Cash and cash equivalents. Carrying value is assumed to represent fair value for cash and cash equivalents that have original maturities of ninety days or less.

FHLB bank stock and restricted securities. It is not practical to determine fair value due to the restricted nature of the securities.

Cash surrender value of life insurance policies. Carrying value approximates fair value.

Loans, net. In accordance with recent accounting guidance, the fair value of loans as of September 30, 2018 was measured using the exit price valuation method, determined primarily by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities or cash flows, while incorporating liquidity and credit assumptions.

Accrued interest receivable. Carrying value approximates fair value.

Deposits. The fair value of demand, non-interest bearing checking, savings and money market deposits is determined as the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the estimated future cash flows using market rates offered for deposits of similar remaining maturities.

Borrowed funds. The fair value of borrowed funds is estimated by discounting the future cash flows using market rates for similar borrowings. Such funds include all categories of debt and debentures in the table above.

Subordinated borrowings. The Company utilizes a pricing service along with internal models to estimate the valuation of its junior subordinated debentures. The junior subordinated debentures re-price every ninety days.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Off-balance-sheet financial instruments. Off-balance-sheet financial instruments include standby letters of credit and other financial guarantees and commitments considered immaterial to the Company's financial statements.

## NOTE 13. NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES

Presented below is net interest income after provision for loan losses for the three and nine months ended September 30, 2018 and 2017, respectively.

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net interest income	\$89,341	\$71,998	\$265,932	\$208,429
Provision for loan losses	6,628	4,900	18,735	14,884
Net interest income after provision for loan losses	\$82,713	\$67,098	\$247,197	\$193,545

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 14. REVENUE

The Company adopted ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," and all subsequent ASU's that modified Topic 606 on January 1, 2018. A cumulative effect adjustment to opening retained earnings was not deemed necessary as the implementation of the new standard did not have a material impact on the measurement or recognition of revenue.

Topic 606 requires the Company to follow a five step process: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. Revenue recognition under Topic 606 depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the goods or services. The Company does not have any material significant payment terms as payment is received at or shortly after the satisfaction of the performance obligation. The value of unsatisfied performance obligations for contracts with an original expected length of one year or less are not disclosed. The Company recognizes incremental costs of obtaining contracts as an expense when incurred for contracts with a term of one year or less.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain non-interest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new standard. Topic 606 is applicable to non-interest revenue streams such as wealth management fees, insurance commissions and fees, administrative services for customer deposit accounts, interchange fees, and sale of owned real estate properties.

Non-interest income streams in-scope of Topic 606 are discussed below.

**Service Charges on Deposit Accounts.** Service charges on deposit accounts consist of monthly service fees (i.e. business analysis fees and consumer service charges) and other deposit account related fees. The Company's performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts. The Company may, from time to time, waive certain fees (e.g., NSF fee) for customers but generally do not reduce the transaction price to reflect variability for future reversals due to the insignificance of the amounts. Waiver of fees reduces the revenue in the period the waiver is granted to the customer.

**Insurance Commissions and Fees.** Commission revenue is recognized as of the effective date of the insurance policy or the date the customer is billed, whichever is later, net of return commissions related to policy cancellations. Policy cancellation is a variable consideration that is not deemed significant and thus, does not impact the amount of revenue recognized.

In addition, the Company may receive additional performance commissions based on achieving certain sales and loss experience measures. Such commissions are recognized when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts.

**Wealth Management Fees.** Wealth management fees is primarily comprised of fees earned from consultative investment management, trust administration, tax return preparation, and financial planning. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based on the



daily accrual of the market value of the investment accounts and the applicable fee rate.

Interchange Fees. Interchange fees are transaction fees paid to the card-issuing bank to cover handling costs, fraud and bad debt costs, and the risk involved in approving the payment. Due to the day-to-day nature of these fees they are settled on a daily basis and are accounted for as they are received.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Gains/Losses on Sales of OREO. The sale of OREO and other nonfinancial assets are accounted for with the derecognition of the asset in question once a contract exists and control of the asset has been transferred to the buyer. The gain or loss on the sale is calculated as the difference between the carrying value of the asset and the transaction price.

The following presents non-interest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine months ended September 30, 2018 and 2017, respectively.

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Non-interest income				
In-scope of Topic 606:				
Service charges on deposit accounts	\$5,276	\$4,094	\$15,613	\$12,290
Insurance commissions and fees	2,930	2,581	8,504	8,305
Wealth management fees	2,283	2,315	7,160	7,127
Interchange income	1,439	1,795	5,721	5,464
Non-interest income (in-scope of Topic 606)	11,928	10,785	36,998	33,186
Non-interest income (out-of-scope of Topic 606)	17,353	18,051	51,833	63,205
Total non-interest income	\$29,281	\$28,836	\$88,831	\$96,391

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

## SELECTED FINANCIAL DATA

The following summary data is based in part on the consolidated financial statements and accompanying notes and other information appearing elsewhere in this or prior Forms 10-Q. Stock price information is for Berkshire's common shares traded on the New York Stock exchange under the symbol "BHLB".

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,		
	2018	2017	2018	2017	
<b>PER SHARE DATA (1)</b>					
Net earnings per common share, diluted	\$0.70	\$0.57	\$1.98	\$1.54	
Adjusted earnings per common share, diluted (1)	0.70	0.59	2.08	1.71	
Total book value per common share	32.84	31.78	32.84	31.78	
Tangible book value per common share (2)	20.68	21.38	20.68	21.38	
Dividend per common share	0.22	0.21	0.66	0.63	
Common stock price:					
High	44.25	39.00	44.25	39.00	
Low	40.00	32.85	35.80	32.85	
Close	40.70	38.75	40.70	38.75	
<b>PERFORMANCE RATIOS (3)</b>					
Return on assets	1.08	% 0.95	% 1.05	% 0.83	%
Adjusted return on assets (1)	1.08	0.98	1.10	0.92	
Return on equity	8.27	7.26	7.96	6.63	
Adjusted return on equity (1)	8.28	7.47	8.36	7.37	
Adjusted return on tangible equity (1)	13.67	11.42	13.97	11.78	
Net interest margin, fully taxable equivalent (FTE) (4)	3.32	3.36	3.39	3.35	
Fee income/Net interest and fee income	24.33	29.96	24.69	30.76	
Efficiency ratio (2)	57.15	59.28	57.66	60.96	
<b>GROWTH RATIOS</b>					
Total commercial loans, (annualized)	6	% 1	% 5	% 9	%
Total loans, (annualized)	9	5	10	8	
Total deposits, (annualized)	(3	) 4	—	3	
Total net revenues, (compared to prior year period)	18	31	16	37	
Earnings per share, (compared to prior year period)	23	8	29	(2	)
Adjusted earnings per share, (compared to prior year period) (2)	19	2	22	4	
<b>FINANCIAL DATA: (In millions)</b>					
Total assets	\$12,030	\$9,767	\$12,030	\$9,767	
Total earning assets	10,957	8,944	10,957	8,944	
Total securities	1,918	1,824	1,918	1,824	
Total borrowings	1,540	1,489	1,540	1,489	
Total loans	8,905	6,947	8,905	6,947	
Allowance for loan losses	58	49	58	49	
Total intangible assets	553	420	553	420	
Total deposits	8,766	6,790	8,766	6,790	
Total stockholders' equity	1,532	1,285	1,532	1,285	



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	At or for the Three Months Ended September 30, 2018		At or for the Nine Months Ended September 30, 2018		At or for the Three Months Ended September 30, 2017		At or for the Nine Months Ended September 30, 2017	
<b>ASSET QUALITY AND CONDITION RATIOS (5)</b>								
Net charge-offs (annualized)/average loans	0.19	% 0.19	% 0.19	% 0.20	% 0.19	% 0.20	%	%
Total non-performing assets/total assets	0.30		0.23		0.30		0.23	
Allowance for loan losses/total loans	0.66		0.71		0.66		0.71	
Loans/deposits	102		102		102		102	
Shareholders' equity to total assets	12.74		13.15		12.74		13.15	
Tangible shareholders' equity to tangible assets (2)	8.53		9.25		8.53		9.25	
<b>FOR THE PERIOD: (In thousands)</b>								
Net interest income	\$89,341		\$71,998		\$265,932		\$208,429	
Non-interest income	29,281		28,836		88,831		96,391	
Net revenue	118,622		100,834		354,763		304,820	
Provision for loan losses	6,629		4,900		18,735		14,884	
Non-interest expense	70,977		65,820		220,183		209,669	
Net income	32,227		22,903		91,506		58,057	
Adjusted Income (1)	32,245		23,554		96,202		64,513	

(1) Adjusted measurements are non-GAAP financial measures that are adjusted to exclude net non-operating charges primarily related to acquisitions and restructuring activities. Refer to the Reconciliation of Non-GAAP Financial Measures for additional information.

(2) Non-GAAP financial measure.

(3) All performance ratios are annualized and are based on average balance sheet amounts, where applicable.

(4) Fully taxable equivalent considers the impact of tax advantaged investment securities and loans.

(5) Generally accepted accounting principles require that loans acquired in a business combination be recorded at fair value, whereas loans from business activities are recorded at cost. The fair value of loans acquired in a business combination includes expected loan losses, and there is no loan loss allowance recorded for these loans at the time of acquisition. Accordingly, the ratio of the loan loss allowance to total loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Similarly, net loan charge-offs are normally reduced for loans acquired in a business combination since these loans are recorded net of expected loan losses.

Therefore, the ratio of net loan charge-offs to average loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Other institutions may have loans acquired in a business combination, and therefore there may be no direct comparability of these ratios between and among other institutions.

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## AVERAGE BALANCES AND AVERAGE YIELDS/RATES

The following table presents average balances and an analysis of average rates and yields on an annualized fully taxable equivalent basis for the periods included:

(\$ In millions)	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2017			Three Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	Average Balance (FTE basis)	Yield/Rate		Average Balance (FTE basis)	Yield/Rate		Average Balance (FTE basis)	Yield/Rate		Average Balance (FTE basis)	Yield/Rate	
<b>Assets</b>												
<b>Loans:</b>												
Commercial real estate	\$3,331	4.67	%	\$2,669	4.64	%	\$3,296	4.84	%	\$2,664	4.54	%
Commercial and industrial loans	1,824	6.22		1,184	5.09		1,817	5.71		1,129	5.08	
Residential mortgages	2,460	3.66		1,978	3.68		2,290	3.65		1,918	3.62	
Consumer loans	1,121	4.27		1,030	3.88		1,116	4.14		1,002	3.77	
Total loans (1)	8,736	4.66		6,861	4.33		8,519	4.61		6,713	4.26	
Investment securities (2)	1,929	3.36		1,779	3.43		1,931	3.36		1,702	3.42	
Short term investments & loans held for sale (3)	167	3.82		168	3.40		151	3.70		145	2.95	
Total interest-earning assets	10,832	4.41		8,808	4.13		10,601	4.36		8,560	4.07	
Intangible assets	554			421			555			422		
Other non-interest earning assets	524			402			530			387		
Total assets	\$11,910			\$9,631			\$11,686			\$9,369		
<b>Liabilities and shareholders' equity</b>												
<b>Deposits:</b>												
NOW and other	\$845	0.58	%	\$571	0.26	%	\$793	0.44	%	\$573	0.24	%
Money market	2,349	0.92		1,768	0.57		2,463	0.84		1,789	0.54	
Savings	741	0.15		670	0.14		745	0.14		662	0.14	
Time	3,275	1.76		2,588	1.20		3,024	1.57		2,471	1.14	
Total interest-bearing deposits	7,209	1.18		5,597	0.78		7,025	1.04		5,495	0.73	
Borrowings and notes (4)	1,375	2.42		1,457	1.65		1,352	2.24		1,418	1.50	
Total interest-bearing liabilities	8,584	1.38		7,054	0.96		8,377	1.23		6,913	0.89	
Non-interest-bearing demand deposits	1,636			1,196			1,659			1,177		
Other non-interest earning liabilities	132			119			116			112		
Total liabilities	10,352			8,369			10,152			8,202		
Total shareholders' equity (2)	1,558			1,262			1,534			1,167		
Total liabilities and stockholders' equity	\$11,910			\$9,631			\$11,686			\$9,369		

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	Average Balance	Average Balance	Average Balance	Average Balance
	Yield/Rate (FTE basis)	Yield/Rate (FTE basis)	Yield/Rate (FTE basis)	Yield/Rate (FTE basis)
Net interest spread	3.03 %	3.17 %	3.14 %	3.18 %
Net interest margin (5)	3.32	3.36	3.39	3.35
Cost of funds	1.16	0.82	1.03	0.76
Cost of deposits	0.96	0.64	0.84	0.60
Supplementary data				
Total deposits (In millions)	\$8,844	\$6,793	\$8,684	\$6,672
Fully taxable equivalent income adj. (In thousands) (6)	1,807	2,950	3,841	8,105

(1) The average balances of loans include nonaccrual loans and deferred fees and costs.

(2) The average balance for securities available for sale is based on amortized cost. The average balance of equity also reflects this adjustment.

(3) Interest income on loans held for sale is included in loan interest income on the income statement.

(4) The average balances of borrowings includes the capital lease obligation presented under other liabilities on the consolidated balance sheet.

Purchased loan accretion totaled \$4.5 million and \$3.1 million for the three months ended September 30, 2018 and (5) 2017, respectively. Purchased loan accretion totaled \$14.9 million and \$6.3 million for the nine months ended September 30, 2018 and 2017, respectively.

(6) Fully taxable equivalent considers the impact of tax advantaged investment securities and loans.

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NON-GAAP FINANCIAL MEASURES

This document contains certain non-GAAP financial measures in addition to results presented in accordance with Generally Accepted Accounting Principles (“GAAP”). These non-GAAP measures are intended to provide the reader with additional supplemental perspectives on operating results, performance trends, and financial condition. Non-GAAP financial measures are not a substitute for GAAP measures; they should be read and used in conjunction with the Company’s GAAP financial information. A reconciliation of non-GAAP financial measures to GAAP measures is provided below. In all cases, it should be understood that non-GAAP measures do not depict amounts that accrue directly to the benefit of shareholders. An item which management excludes when computing non-GAAP adjusted earnings can be of substantial importance to the Company’s results for any particular quarter or year. The Company’s non-GAAP adjusted earnings information set forth is not necessarily comparable to non-GAAP information which may be presented by other companies. Each non-GAAP measure used by the Company in this report as supplemental financial data should be considered in conjunction with the Company’s GAAP financial information.

The Company utilizes the non-GAAP measure of adjusted earnings in evaluating operating trends, including components for operating revenue and expense. These measures exclude amounts which the Company views as unrelated to its normalized operations, including securities gains/losses, gains on the sale of business operations and assets, losses recorded for hedge terminations, merger costs, restructuring costs, legal settlements, systems conversion costs, and out-of-period adjustments. Securities gains/losses include gains/losses on equity securities beginning in the first quarter of 2018. Non-GAAP adjustments are presented net of an adjustment for income tax expense.

The Company also calculates adjusted earnings per share based on its measure of adjusted earnings and based on diluted common shares. The Company views these amounts as important to understanding its operating trends, particularly due to the impact of accounting standards related to merger and acquisition activity. Analysts also rely on these measures in estimating and evaluating the Company’s performance. Management also believes that the computation of non-GAAP adjusted earnings and adjusted earnings per share may facilitate the comparison of the Company to other companies in the financial services industry.

Charges related to merger and acquisition activity consist primarily of severance/benefit related expenses, contract termination costs, system conversion costs, variable compensation expenses, and professional fees. Systems conversion costs relate primarily to the Company’s core systems conversion and related systems conversions costs. Restructuring costs primarily consist of the Company’s continued effort to create efficiencies in operations through calculated adjustments to the branch banking and office footprint. Expense adjustments include variable rate compensation related to non-operating items.

The Company also adjusts certain equity related measures to exclude intangible assets due to the importance of these measures to the investment community.



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## RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

The following table summarizes the reconciliation of non-GAAP items recorded for the periods indicated:

(In thousands)	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,	
	2018	2017	2018	2017
GAAP Net income	\$32,227	\$22,903	\$91,506	\$58,057
Adj: (Gains)/losses on securities, net (1)	(88	)1	696	(12,568 )
Adj: Loss on termination of hedges	—	—	—	6,629
Adj: Net losses/(gains) on sale of business operations and assets	—	(296 )	(460 )	(296 )
Adj: Merger and acquisition expense	198	1,110	6,138	9,323
Adj: Restructuring and other expense	—	310	—	6,682
Adj: Income taxes	(92	)(474 )	(1,678 )	(3,314 )
Total adjusted income (non-GAAP) (2)	(A) \$32,245	\$23,554	\$96,202	\$64,513
GAAP Total revenue	\$118,622	\$100,834	\$354,763	\$304,820
Adj: (Gains)/losses on securities, net (1)	(88	)1	696	(12,568 )
Adj: Net (gains) on sale of business operations and assets	—	(296 )	(460 )	(296 )
Adj: Loss on termination of hedges	—	—	—	6,629
Total operating revenue (non-GAAP) (2)	(B) \$118,534	\$100,539	\$354,999	\$298,585
GAAP Total non-interest expense	\$70,977	\$65,820	\$220,183	\$209,669
Less: Total non-operating expense (see above)	(198	)(1,420 )	(6,138 )	(16,005 )
Operating non-interest expense (non-GAAP) (2)	(C) \$70,779	\$64,400	\$214,045	\$193,664
(In millions, except per share data)				
Total average assets	(D) \$11,910	\$9,631	\$11,687	\$9,369
Total average shareholders' equity	(E) 1,558	1,262	1,534	1,167
Total average tangible shareholders' equity (2)	(F) 1,004	841	978	746
Total average tangible common shareholders' equity (2)	(G) 963	—	937	—
Total tangible shareholders' equity, period-end (2)(3)	(H) 979	864	979	864
Total tangible common shareholders' equity, period-end (2)(3)	(I) 939	—	939	—
Total tangible assets, period-end (2)(3)	(J) 11,477	9,346	11,477	9,346
Total common shares outstanding, period-end (thousands)	(K) 45,420	40,424	45,420	40,424
Average diluted shares outstanding (thousands)	(L) 46,263	40,145	46,226	37,708
Earnings per common share, diluted	\$0.70	\$0.57	\$1.98	\$1.54
Adjusted earnings per common share, diluted (2)	(A/L) 0.70	0.59	2.08	1.71
Book value per common share, period-end	32.84	31.78	32.84	31.78
Tangible book value per common share, period-end (2)	(I/K) 20.68	21.38	20.68	21.38
Total shareholders' equity/total assets	12.74	13.15	12.74	13.15
Total tangible shareholder's equity/total tangible assets (2)	(H/J) 8.53	9.25	8.53	9.25

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Performance ratios (4)						
GAAP return on assets		1.08	%0.95	% 1.05	%0.83	%
Adjusted return on assets (2)	(A/D)	1.08	0.98	1.10	0.92	
GAAP return on equity		8.27	7.26	7.96	6.63	
Adjusted return on equity (2)	(A/E)	8.28	7.47	8.36	7.37	
Adjusted return on tangible common equity (2)(5)	(A+O)/(J)	13.67	11.42	13.97	11.78	
Efficiency ratio (2)	(C-O)/(B+M+P)	57.15	59.28	57.66	60.96	
Supplementary data (In thousands)						
Tax benefit on tax-credit investments (6)	(M)	\$1,374	\$3,905	\$4,089	\$7,225	
Non-interest income charge on tax-credit investments (7)	(N)	(1,112 )	(3,347 )	(3,212 )	(6,129 )	
Net income on tax-credit investments	(M+N)	262	558	877	1,096	
Intangible amortization	(O)	1,218	739	3,732	2,310	
Fully taxable equivalent income adjustment	(P)	1,807	2,950	5,660	8,105	

(1) Net securities losses/(gains) for the period ending September 30, 2018 includes the change in fair value of the Company's equity securities in compliance with the Company's adoption of ASU 2016-01.

(2) Non-GAAP financial measure.

(3) Total tangible shareholders' equity is computed by taking total shareholders' equity less the intangible assets at period-end. Total tangible assets is computed by taking total assets less the intangible assets at period-end.

(4) Ratios are annualized and based on average balance sheet amounts, where applicable.

Adjusted return on tangible common equity is computed by dividing the total adjusted income adjusted for the

(5) tax-affected amortization of intangible assets, assuming a 27.32% marginal rate for September 30, 2018 and a 40% marginal rate for September 30, 2017, by tangible equity.

(6) The tax benefit is the direct reduction to the income tax provision due to tax credits and deductions generated from investments in historic rehabilitation and low-income housing.

(7) The non-interest income charge is the reduction to the tax-advantaged commercial project investments, which are incurred as the tax credits are generated.

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GENERAL

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company. The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and the notes thereto appearing in Part I, Item 1 of this document and with the Company's consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2017 Annual Report on Form 10-K. In the following discussion, income statement comparisons are against the same period of the previous year and balance sheet comparisons are against the previous fiscal year-end, unless otherwise noted. Operating results discussed herein are not necessarily indicative of the results for the year 2018 or any future period. In management's discussion and analysis of financial condition and results of operations, certain reclassifications have been made to make prior periods comparable. Tax-equivalent adjustments in the first nine months of 2018 are the result of increasing income from tax-advantaged loans and securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 27% marginal rate (including state income taxes net of federal benefit), which is reduced from 39% in 2017. This reduction is primarily due to a reduction in the federal corporate income tax rate from 35% to 21% as a result of the federal tax reform enacted at the end of 2017 and effective beginning in 2018. In the discussion, unless otherwise specified, references to earnings per share and "EPS" refer to diluted earnings per common share, including the dilutive impact of the convertible preferred shares.

Berkshire Hills Bancorp, Inc. ("Berkshire" or "the Company") is a Delaware corporation headquartered in Boston and the holding company for Berkshire Bank ("the Bank") and Berkshire Insurance Group. Established in 1846, the Bank operates as a commercial bank under a Massachusetts trust company charter. Berkshire Bank operates under the brand America's Most Exciting Bank®.

Berkshire is a regional financial services company that seeks to distinguish itself over the long term based on the following attributes:

- Strong earnings momentum and improving profitability
- Boston-based regional banking company delivering franchise value in attractive markets
- Distinctive culture drives results
- Disciplined regional consolidator
- Focused on profitability goals and building shareholder value

Shown below is a profile of the Company:

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**FORWARD-LOOKING STATEMENTS**

Certain statements contained in this document that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the Securities Exchange Act), and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words “may,” “will,” “should,” “could,” “would,” “plan,” “potential,” “estimate,” “believe,” “intend,” “anticipate,” “expect,” “target” and similar expressions. These forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions, increased competitive pressures, changes in the interest rate environment, legislative and regulatory change, changes in the financial markets, and other risks and uncertainties disclosed from time to time in documents that Berkshire Hills Bancorp files with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the fiscal year ended December 31, 2017 and the Risk Factors in Item 1A of this report. Because of these and other uncertainties, Berkshire’s actual results, performance or achievements, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, Berkshire’s past results of operations do not necessarily indicate Berkshire’s combined future results. You should not place undue reliance on any of the forward-looking statements, which speak only as of the dates on which they were made. Berkshire is not undertaking an obligation to update forward-looking statements, even though its situation may change in the future, except as required under federal securities law. Berkshire qualifies all of its forward-looking statements by these cautionary statements.

**SUMMARY**

2018 results included the operations of Worcester-based Commerce Bancshares Corp., which were acquired in October 2017, expanding Berkshire’s Greater Boston presence and market share. With the benefit of this acquisition and other initiatives, earnings and profitability metrics have increased strongly in 2018. Highlights of the year-over-year improvement in third quarter performance metrics included:

- 41% increase in net income to \$32 million
- 23% increase in earnings per share to \$0.70
- 18% increase in net revenue to \$119 million
- 14% improvement in return on assets to 1.08%
- 14% improvement in return on equity to 8.3%

These results were achieved while the Company was absorbing the increased compliance costs related to crossing the \$10 billion asset threshold, and while the Company was investing in its Boston headquarters relocation and team buildout. Results also benefited from a lower tax rate following federal tax reform at the end of 2017. Berkshire increased its quarterly shareholder dividend by 5% to \$0.22 per common share in the first quarter of 2018, matching a similar increase in the first quarter of 2017.

The third quarter was the first full quarter in 2018 with the fully integrated operations of prior business acquisitions. While the Company is focused on achieving further organic benefit from the existing operations, its capital profile and capacity for further acquisitions are viewed as consistent with its goal of being positioned to take advantage of further consolidation in its regions as opportunities may arise. The Company’s goal is to identify the best organic and other opportunities across its markets to profitably increase its market share based on the strength of its markets, its appeal to customer preference, and its competitive positioning.

During the most recent quarter, Berkshire saw good activity in many of its business lines, including accelerated activity by the recently expanded Boston and mid-Atlantic teams. The Company’s specialty lending teams delivered record loan related fee income, working cohesively across the footprint, and led by the SBA team which broke into the top 30 nationally based on both units and dollar volume. The Company is focusing on its MyBanker program as a key

focus for deposit acquisition across its expanded footprint. It has preliminarily identified six branches for consolidation and is pursuing efficiencies in its technology management.

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The Company recently promoted four individuals to Senior Executive Vice President, reporting to the CEO. These include the Chief Risk Officer, the Chief Credit Officer, the General Counsel, and the newly named Chief Administrative Officer, who oversees technology, corporate strategy, and innovation. The President expanded his responsibilities to include Commercial Banking, Loan Workout, and Corporate Diversity. The Chief Operating Officer expanded his responsibilities to include Human Resources and Culture initiatives. The Chief Financial Officer's responsibilities were expanded to include Facilities.

The Bank was recognized in the third quarter by a United Nations IMPACT2030 Innovation Award for its support of volunteerism, including its award-winning XTeam employee volunteer program. Earlier in the year, the Company's strengthened financial condition was recognized with an A- bank deposit rating assigned by the KBRA Bond Rating Agency. Berkshire's stock was added in the second quarter to the S&P 600 SmallCap<sup>®</sup> index, which tracks U.S. small cap companies and is included in the S&P Composite 1500<sup>R</sup> index, facilitating an expanded market for the Company's stock.

Economic conditions remain sound in the Company's markets, and the Company maintains a focus on Greater Boston, Albany, and the Mid-Atlantic as its strongest regional markets. The yield curve increased and flattened in 2018 as a result of 25 basis point increases in the target fed funds rate by the Federal Reserve Bank in the final month of each of the last four quarters. Loan and deposit pricing spreads have been pressured under these conditions, and are also believed to reflect the competitive impacts from the reduction in the corporate federal income tax rate from 35% to 21% enacted at the end of 2017.

### COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2018 AND DECEMBER 31, 2017

Summary: Total assets increased by \$0.5 billion, or 4%, to \$12.0 billion during the first nine months of 2018. This was due to a \$0.6 billion increase in total loans, which was funded by a \$0.4 billion increase in borrowings, along with seasonal reductions in cash equivalents and mortgages held for sale. Most major balance sheet metrics remained strong while slightly decreasing, including capital, liquidity, interest rate sensitivity, and asset quality. Book value per share increased by 2% to \$32.84, and the non-GAAP measure of tangible book value per common share increased by 4% to \$20.68.

Securities: There were no major changes in the securities portfolio, which increased by 1% to \$1.9 billion for the year-to-date. At period-end, highly pledgeable and liquid mortgage backed securities constituted 65% of the portfolio, with 20% in municipal bonds, 11% in corporate securities, and 4% in Federal Home Loan Bank ("FHLBB") stock. Excluding the FHLBB stock, management estimates that approximately 95% of the portfolio was invested in securities that are investment grade or equivalent, with hold limits and diversification standards also applied across the portfolio. The average yield decreased to 3.36% in the most recent quarter from 3.55% in the fourth quarter of 2017. The yield in 2018 decreased due to the loss of fully taxable equivalent yield on municipal securities resulting from the reduction in the federal tax rate. These municipal securities continued to meet the Company's overall portfolio objectives. The Company estimated that this reduced the securities portfolio yield by 0.20% in the most recent quarter. The benefit of higher interest rates was offset by narrower market spreads on portfolio runoff and reinvestment. The weighted average life was 5.9 years at period-end, compared to 5.5 years at the start of the year, including the effect of slower prepayment speeds resulting from higher interest rates. The unrealized loss on the securities portfolio measured 2.4% of cost at quarter-end, compared to a 0.6% gain at the start of the year, reflecting lower bond prices stemming from the increase in interest rates. Due to a change in accounting principles, beginning in 2018, the change in net fair value of marketable equity securities is recorded to non-interest income rather than to accumulated other comprehensive income. The Company has elected to disclose these securities separately on the statement of financial condition. There were no securities deemed impaired during the year and at period-end.

Loans: Total loans increased for the first nine months of the year by \$0.6 billion, or 7%, to \$8.9 billion. Commercial loans grew by \$0.2 billion, or 4%, and residential mortgages increased by \$0.4 billion, or 19%. Growth in commercial

loans included the benefit of the Company's expansion in Greater Boston. Commercial loans comprised 59% of total loans at period-end and continue to be a central strategic focus. The Company has expanded its commercial teams in Greater Boston and the Mid-Atlantic based on growth opportunities in those markets. Increased loan originations have more than offset higher payoff activity.

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Commercial loan growth was split between commercial real estate and commercial and industrial loans. C&I loan bookings during the nine months included a number of industries across a number of geographies. Growth in commercial real estate was spread across construction, multifamily, owner-occupied, and investor properties. Berkshire's total non-owner occupied commercial real estate exposure measured 240% of bank regulatory capital at period-end, compared to the 300% regulatory monitoring guidelines (based on regulatory definitions). Construction loan exposure was 34% of bank regulatory capital, compared to the 100% regulatory monitoring guideline.

Berkshire originates prime residential mortgages through its First Choice Loan Services subsidiary. Mortgage loan growth in 2018 was primarily comprised of jumbo loans in Eastern Massachusetts originated by Berkshire. The Company sells most of its conforming mortgage originations servicing released, while local jumbo loans are retained for investment to support relationship and market objectives. Residential mortgages added to the portfolio were split between adjustable rate and fixed rate loans.

The 2018 third quarter loan portfolio yield increased to 4.66% compared to 4.47% in the fourth quarter of 2017 due primarily to the increase in interest rates during the year to date. At period-end, the remaining accretable balance of purchased impaired loans totaled \$4.6 million. Purchased loan accretion recorded to income in the first nine months of 2018 totaled \$15 million, including \$11 million contributed by recoveries of purchased credit impaired loans.

At period-end, 43% of total loans contractually repriced within one year, 21% repriced in one to five years, and 36% repriced after five years.

Asset Quality: Loan quality metrics generally remained favorable during the first nine months of 2018. Annualized net loan charge-offs for this period were 0.19% of average loans. Nonperforming assets remained comparatively low, rising to 0.27% of total assets in the first quarter of 2018 and then to 0.30% of total assets at September 30, 2018. Approximately 45% of the \$36 million period end balance of nonperforming assets was related to one commercial real estate relationship in the Company's footprint which became delinquent during the year and is viewed as adequately secured by real estate and which does not require a specific impaired loan reserve. Accruing delinquent loans increased to 0.60% of total loans at period-end compared to 0.55% at the start of the year. At period-end, the total contractual balance of purchased credit impaired loans was \$154 million, with a \$63 million carrying value, or 41% of the contractual balance. Asset resolution strategies during the year contributed to the reduction in these balances from \$209 million and \$97 million at the start of the year. The contractual balance included Boston area taxi medallion loans acquired at a significant merger discount, and which had a net carrying value less than \$30 million at period-end. Criticized loans measured 1.8% of total assets at period-end, compared to 1.6% at the start of the year. The balance related to acquired loans decreased to \$97 million from \$107 million due to workout strategies. The balance related to loans from business activities increased to \$119 million from \$81 million, primarily due to several existing commercial relationships in the \$2-5 million range with no geographic or borrower type concentrations. Criticized commercial loans from business activities measured 2.9% of related outstandings at period-end.

Deposits and Borrowings: Total average deposits increased by 4% in the third quarter of 2018, compared to the first quarter of 2018, which was the first full quarter including the Commerce operations. This included a 5% increase in lower cost relationship oriented average transaction account balances (consisting of demand deposits and NOW deposits). Fluctuations in total deposits can include large daily fluctuations related to the payroll service business line acquired with Commerce.

Period-end total deposits remained flat at \$8.8 billion during the first nine months of the year. Payroll service related deposits decreased by \$153 million to \$359 million. Brokered time deposits increased by \$251 million to \$1.33 billion, offsetting the lower payroll related balances and decreases in personal account balances. Non-interest bearing transaction account balances declined while interest bearing transaction account balances increased. Some money



market balances shifted into higher interest time accounts. Due to the increase in interest rates, the average cost of deposits increased by 0.30% to 0.96% in the most recent quarter from 0.66% in the fourth quarter of 2017. The increase in deposit costs accelerated sequentially in each quarter as the market became more sensitive to the prevailing higher interest rates. The cost of average interest bearing deposits increased by 0.36% during the same

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period. Total borrowings increased by \$0.4 billion, or 35%, to \$1.5 billion during the first nine months of 2018. FHLB borrowings were used primarily to support loan growth. Borrowing costs increased due to higher rates and the total cost of funds, including deposit costs, increased to 1.16% in the most recent quarter from 0.81% in the fourth quarter of 2017.

Derivative Financial Instruments: The notional balance of derivative financial instruments increased to \$3.1 billion at period-end from \$2.5 billion at the start of the year. This included a \$247 million increase related to commercial loan interest rate swaps originated during the year and a similar increase in matching hedges with national counterparties. The net fair value of total derivatives increased to \$5 million from \$3 million during the period.

Shareholders' Equity: Shareholders' equity increased by \$36 million, or 2%, to \$1.5 billion in the first nine months of the year. The benefit of retained earnings was partially offset by a reduction in accumulated other comprehensive income resulting from the unrealized bond losses discussed previously in the Securities section. As a result, capital metrics decreased slightly, with the ratio of equity to assets measuring 12.7% at period-end compared to 12.9% at the start of the year. The non-GAAP measure of tangible equity to tangible assets was unchanged at 8.5%.

The third quarter return on equity improved by 14% to 8.3%, and the return on assets improved by a similar fraction to 1.08%. The third quarter non-GAAP measure of adjusted return on tangible common equity improved by 20% to 13.7%. The Company focuses on this measure in assessing internal capital generation to support dividends and organic growth.

COMPARISON OF OPERATING RESULTS FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND SEPTEMBER 30, 2017

Summary: Third quarter net income increased year-over by 41% to \$32 million, due primarily to the benefit of positive operating leverage from business growth including expansion in Greater Boston through acquisition and business development. EPS increased by 23% year-over-year, and included the impact of shares issued as merger consideration. There were negligible net adjusting items during the most recent quarter, and both GAAP EPS and the non-GAAP adjusted EPS measure totaled \$0.70. The third quarter ROA measured 1.08%, while the efficiency ratio improved year-over-year to 57.2%. This measure utilizes the non-GAAP measures of adjusted revenue and adjusted expense. The third quarter return on equity was 8.3%, while the non-GAAP measure of adjusted return on tangible common equity was 13.7%. For the first nine months of the year, net income increased by 58% to \$92 million from \$58 million. Nine month earnings per share increased by 29% to \$1.98 from \$1.54. The non-GAAP measure of adjusted earnings per share increased by 22% to \$2.08 from \$1.71.

Revenue and expense in 2018 included the Commerce operations acquired on October 13, 2017. As a result, most categories of revenue and expense increased over the same period of 2017. Most categories of interest income and expense also increased due to the increase in market interest rates. Additionally, 2018 operations included the benefit of First Choice cost saves and hedge terminations and restructuring actions which affected 2017 results. Based on its pro forma analysis in the Company's Form 10-K, the Company expected the Commerce acquisition to be accretive to earnings and earnings per share, including the cost saves targeted to be achieved in 2018. Operations in 2018 also benefited from the lower federal income tax rate, which reduced the effective tax rate compared to 2017 and benefited nine month EPS by approximately \$0.17 in 2018 compared to 2017. Earnings per share reflected the shares issued as merger consideration for the Commerce acquisition.

The Company's adjustments to revenue, expense, income, and related measures were previously discussed in the reconciliation of non-GAAP financial measures. For the first nine months of 2018, non-GAAP adjustments to net income equated to an increase of \$0.10 per share after tax and were primarily related to merger related expenses, along with net securities losses and net gains on sales of business operations. In 2017, significant adjustments were

also recorded for income on the sale of equity securities and losses related to the termination of hedging derivative contracts, as well as restructuring expenses. Net non-GAAP adjustments in 2017 equated to an increase of \$0.17 per share after tax.

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**Revenue:** Net revenue advanced year-over-year by 18% and 16% for the third quarter and nine months, respectively, mostly due to volume related growth in net interest income. Much of this increase was attributed to the Commerce acquisition, based on the pro forma analysis of combined operations in the most recent Form 10-K. Revenue in the most recent quarter totaled \$119 million, or \$474 million annualized. Annualized third quarter revenue per share totaled \$10.26 in 2018, compared to \$10.05 in 2017.

**Net Interest Income:** Net interest income increased year-over-year by 24% and 28% in the third quarter and for the first nine months, respectively. Average earning assets increased by 23% and 24% for these respective periods, including the benefit of the Commerce acquisition and growth in loans from business activities.

The net interest margin decreased to 3.32% from 3.36% for the third quarter and increased to 3.39% from 3.35% for the first nine months in 2018 compared to 2017. The net interest margin was 3.50% in the fourth quarter of 2017, the first quarter that included the assets and liabilities acquired with Commerce. The contribution from purchased loan accretion was 0.17% in the most recent quarter, compared to 0.21% in the last quarter of 2017. The margin before accretion decreased by 0.14% between those quarters, including an estimated 0.05% impact from the change in the taxable equivalent benefit following the reduction in the federal income tax rate. The margin in the third quarter also decreased by approximately 0.03% due to the increase in non-accruing loans. Additionally, the margin has declined due to the impacts of business growth, market competition, shifts in business mix, and the flattening of the yield curve. The Company's modeled neutral asset sensitivity to higher interest rates assumes a static balance sheet and an unchanged shape of the yield curve. While deposit costs have increased in 2018 generally in line with the 40% deposit beta assumed in the Company's modeling, growth has been funded by higher cost borrowings and the earning asset beta has been closer to 25% before loan accretion. These impacts became more pronounced in the most recent quarter, compared to earlier quarters in 2018. These beta measures are an indicator of sensitivity to market interest rate changes.

**Non-Interest Income:** Loan and deposit fee income increased year-over-year by 16% in the third quarter and 21% for the first nine months of the year. Quarterly loan related income increased year over year by 24%, reaching a record \$7.5 million primarily due to higher SBA loan sale gains. In the national SBA 7A loan origination rankings, Berkshire was in the top thirty originators both in terms of dollars and number of approved loans. Deposit related fees increased year-over-year by 9% for the third quarter and by 18% for the year-to-date. As a result of crossing the \$10 billion asset regulatory threshold in the fourth quarter of 2017, Berkshire became subject to a reduction in card related fees mandated by the Durbin Amendment to the Dodd-Frank Act, beginning on July 1, 2018. Debit card related fee income decreased by \$1.2 million to \$1.3 million in the third quarter of 2018 compared to the prior quarter primarily due to the impact of this regulation. Mortgage industry revenue contracted year-over-year due to lower demand as a result of higher interest rates. The Company's nine month mortgage banking revenue declined year-over-year by 31% and was mostly offset by a reduction in estimated related expenses. Non-interest income includes income on bank owned life insurance and is net of charges related to the amortization of tax credit investments which benefit tax expense. Non-interest income includes items not viewed as related to ongoing operations, including gains/losses on securities and the sale of business operations, along with hedge termination losses.

**Loan Loss Provision:** The nine month loan loss provision increased by 26% year-over-year. The provision exceeded net loan charge-offs and boosted the ratio of the allowance to total loans to 0.66% at period-end, compared to 0.62% at the start of the year. This provision is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company. The level of the allowance is a critical accounting estimate. It is an estimate of the probable and estimable incurred loan losses in the portfolio as of period-end.

**Non-Interest Expense:** Total non-interest expense increased year-over-year by 8% in the third quarter and by 5% for the first nine months of the year. Non-interest expense includes charges viewed as not related to future operations,

consisting primarily of merger and restructuring charges. The non-GAAP measure of adjusted operating expense excludes these items. This measure increased by 10% and 11% for the above periods respectively, including costs related to the acquired Commerce operations. Management views the year-over-year results as

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indicating positive operating leverage, as the revenue increase exceeded expense growth. This was achieved while the Company added overhead costs for increased regulatory compliance related to crossing the \$10 billion asset threshold. The Company also increased its investment in employees and its communities as part of the reinvestment of benefits resulting from federal tax reform, including establishing a minimum wage of \$15/hour beginning at the start of 2018. Additionally, the Company has added to its banking teams in Greater Boston and in the Mid-Atlantic. As previously noted, mortgage banking expenses were reduced as a result of the related revenue decline. Expenses have benefited from the implementation of cost saves for the First Choice Bank and Commerce acquisitions. The Company is moving forward on initiatives to consolidate approximately six branch offices, with a target to reduce ongoing expenses after a potential initial restructuring charge. Two de novo branches were added in attractive markets in the first half of 2018. Due to an amendment to the Dodd-Frank legislation, the Company is no longer required to submit formal capital stress tests and will not have that incremental expense which was planned, although informal stress testing will continue. As a consequence of crossing the \$10 billion asset threshold, management anticipates that FDIC insurance expense will increase by approximately \$1.3 million per year beginning in the fourth quarter of 2018. Total full-time equivalent staff measured 1,970 positions at period-end, compared to 1,992 positions at the start of the year.

**Income Tax Expense:** The Company's nine month effective tax rate decreased year-over-year to 21% from 28%, reflecting the benefit of federal income tax reform which became effective in 2018. The federal statutory tax rate decreased to 21% from 35%, while the state effective tax rate net of federal benefit increased to 5% from 2%. The tax rate benefit from investment tax credits decreased to 3% from 6% for the above respective periods, as the market for tax credit investments decreased following the federal tax reform.

**Total Comprehensive Income:** Total comprehensive income includes net income together with other comprehensive income. Nine month total comprehensive income increased year-over-year to \$64 million from \$59 million. Other comprehensive income was a loss of \$7 million and \$27 million for the third quarter and first nine months of 2018, compared to income of \$1 million in both of the same periods of the prior year. This change primarily reflected the unrealized bond losses in 2018 due to lower bond market prices as a result of increases in market interest rates. The large increase in net income was significantly offset by these unrealized bond losses, with the result that the year-over-year increase in total comprehensive income was 5% and 8% for the above respective periods.

**Liquidity and Cash Flows:** Liquidity declined modestly in the first nine months of 2018, as loan growth was funded with short term wholesale funds. Total wholesale funds, consisting of borrowings and brokered time deposits, increased to \$2.9 billion, or 24% of total assets at period-end, compared to \$2.2 billion, or 19% of total assets, at the start of the year. The Company sometimes uses brokered time deposits as a more cost-effective funds source compared to the Federal Home Loan Bank. Usage of wholesale funds has also increased in 2018 due to the addition of the Commerce payroll service business line, in which deposits fluctuate daily. Payroll deposit balances averaged \$312 million in the most recent quarter, and fluctuations within a quarter can total \$200 million or more. The ratio of loans to deposits increased to 102% from 95% during the first nine months of 2018. This ratio was unchanged from 102% compared to September 30, 2017 prior to the Commerce acquisition. At period-end, the Bank had \$0.8 billion in unused FHLBB borrowing availability, compared to \$1.1 billion at the start of the year. At period-end, the holding company had cash and equivalents totaling \$57 million. In the first quarter of 2018, the holding company downstreamed \$50 million in cash into the Bank as paid in capital to support further bank growth. Additional information about liquidity and cash flows is contained in the related section of the most recent Form 10-K.

**Capital Resources:** Please see the "Shareholders' Equity" section of the Comparison of Financial Condition for a discussion of shareholders' equity together with the note on Shareholders' Equity in the consolidated financial statements. Additional information about regulatory capital is contained in the notes to the consolidated financial statements and in the most recent Form 10-K. There was a slight decrease in capital metrics in the first nine months of 2018 due to the strong loan growth. The increase in earnings and profitability have increased the Company's internal generation of tangible equity which the Company views as supportive of dividends, organic growth, and long term

strengthening of capital metrics. The Company conducts informal capital stress tests but, based on recent

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amendments to the Dodd-Frank Act, it will not be required to submit formal analyses to supervisory authorities. As noted above, the holding company contributed additional cash equity to the Bank in the first quarter. Additionally, subsequent to midyear, the Company converted a \$35 million subordinated note from the Bank into bank equity, to further strengthen Bank capital to support future growth. The Company regularly evaluates conditions in the market for its own stock, as well as market conditions related to mergers and acquisitions and other potential investment opportunities. Its last acquisition agreement was with Commerce, which was announced in May 2017 and closed in October of that year. The Company has a standing authorization from the Board to repurchase up to 500,000 of its common shares. No shares were repurchased under this authorization for the first nine months of 2018.

**Off-Balance Sheet Arrangements and Contractual Obligations:** In the normal course of operations, Berkshire engages in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in the Company's financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. Further information about the Company's off-balance sheet arrangements and information relating to payments due under contractual obligations is presented in the most recent Form 10-K. Changes in the fair value of derivative financial instruments and hedging activities are included on the balance sheet and information related to these matters is reported in the related footnote to the consolidated financial statements, and was included in management's discussion of changes in financial condition. There were no major changes in off-balance sheet arrangements and contractual obligations during the first nine months of 2018.

**Fair Value Measurements:** The most significant fair value measurements recorded by the Company are those related to assets and liabilities acquired in business combinations. The premium or discount value of acquired loans has historically been the most significant element of these measurements. Berkshire provides a summary of estimated fair values of financial instruments at each period-end. The premium or discount value of loans has historically been the most significant element of this period-end presentation. This premium or discount is a Level 3 estimate and reflects management's subjective judgments. At period-end, the premium value of the loan portfolio was \$117 million, or 1.3% of the carrying value, compared to \$175 million, or 2.1% of carrying value at year-end 2017 due to the impact of rising rates on fixed rate loan values. The Company makes further measurements of fair value of certain assets and liabilities, as described in the related note in the financial statements. The most significant measurements of recurring fair values of financial instruments primarily relate to securities available for sale, loans held for sale, and derivative instruments. These measurements were generally based on Level 2 market based inputs.



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**APPLICATION OF CRITICAL ACCOUNTING POLICIES**

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements included in its most recent Annual Report on Form 10-K. Modifications to significant accounting policies made during the year are described in Note 1 to the consolidated financial statements included in Item 1 of this report. The preparation of the consolidated financial statements in accordance with GAAP and practices generally applicable to the financial services industry requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates.

Management has identified the Company's most critical accounting policies as related to:

- ▲ Allowance for Loan Losses
- ▲ Acquired Loans
- ▲ Income Taxes
- ▲ Goodwill and Identifiable Intangible Assets
- ▲ Determination of Other-Than-Temporary Impairment of Securities
- ▲ Fair Value of Financial Instruments

These particular significant accounting policies are considered most critical in that they are important to the Company's financial condition and results, and they require management's subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. The accounting policies and estimates, including the nature of the estimates and types of assumptions used, are described in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's most recent Form 10-K and pertain to discussion in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, of this report.

The notes to the consolidated financial statements describe the Company's implementation plan for ASU No. 2016-13, which changes the accounting for credit losses on financial instruments. While early adoption is allowed, the Company has no current plans to adopt this standard before the beginning of fiscal year 2020. The new guidance may result in an increase in the allowance for loan losses and a decrease in retained earnings, however, the Company is still in the process of determining the magnitude of the change and its impact on the Company's consolidated financial statements. The composition of the loan and securities portfolio, as well as the status of the economic environment, will be significant factors that impact the balances at date of adoption. Among other things, this new standard directs that the accretion of credit related purchased loan discount will be recorded to the loan loss allowance. This accretion is currently recorded to loan interest income and it has historically contributed to loan interest income in most periods.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes to the way that the Company measures market risk in the first nine months of 2018. For further discussion about the Company's Quantitative and Qualitative Aspects of Market Risk, please review Item 7A of the most recent report on Form 10-K which sets forth the methodologies employed by the Company and the various aspects of its analysis of its interest rate sensitivity. Berkshire's objective is to maintain a neutral or asset sensitive interest rate risk profile, as measured by the sensitivity of net interest income to market interest rate changes.

The Company's model of interest rate sensitivity assumes parallel ramped changes in interest rates and a static balance sheet. Based on this model, the Company estimates that its interest rate risk profile was generally neutral to changes in interest rates at September 30, 2018, compared to modest asset sensitivity at the start of the year. This change was primarily due to growth of loans supported by shorter term funding. At period-end, modeled net interest income was approximately flat in the second year of an up 200 basis point ramp. The loss representing the economic value of equity at risk increased modestly to 7% at period-end from 5% at the start of the year in a 200 basis point upward move in interest rates. The Company estimates that its deposit interest rate sensitivity in 2018 has approximated the 40% beta level utilized in the Company's modeling. As anticipated, the early sensitivity was below 40%, but the beta rose to an estimated 52% in the most recent quarter as market sensitivity has heightened. The Company's modeling assumes no shift in the deposit mix in rate change scenarios. The beta of the yield on earning assets has been less than modeled, as previously noted in the discussion of net interest income. Estimated net interest income and net income at risk under the forward curve scenario have also become less asset sensitive. Also, the baseline scenario of flat interest rates demonstrates medium term pressure on the net interest margin from the roll-down of long term assets resulting from scheduled repricing.

Deposit activity in the banking industry is beginning to react to the trend of increasing short term rates following the prolonged time when rates were very low. Uncertainties also exist regarding the impact of lower federal income taxes on industry pricing competition. The Company's goal is to achieve comparative benefit based on its diversified markets and sources in managing its deposit pricing and balance sheet structuring to achieve its market, earnings, and risk objectives.

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ITEM 4. CONTROLS AND PROCEDURES

a) Disclosure controls and procedures.

The principal executive officers, including the principal financial officer, based on their evaluation of disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that the Company's disclosure controls and procedures were effective.

b) Changes in internal control over financial reporting.

There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II

ITEM 1. LEGAL PROCEEDINGS

As of September 30, 2018, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. Periodically, there have been various claims and lawsuits involving the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans, and other issues incident to the Bank's business. However, other than the items noted below, neither the Company nor the Bank is a defendant party to any pending legal proceedings that it believes, in the aggregate, would have a material adverse effect on the financial condition or operations of the Company. Additionally, an estimate of future, probable losses cannot be estimated as of September 30, 2018.

On April 28, 2016, Berkshire Hills and Berkshire Bank were served with a complaint filed in the United States District Court, District of Massachusetts, Springfield Division. The complaint was filed by an individual Berkshire Bank depositor, who claims to have filed the complaint on behalf of a purported class of Berkshire Bank depositors, and alleges violations of the Electronic Funds Transfer Act and certain regulations thereunder, among other matters. On July 15, 2016, the complaint was amended to add purported claims under the Massachusetts Consumer Protection Act. The complaint seeks, in part, compensatory, consequential, statutory, and punitive damages. Berkshire Hills and Berkshire Bank deny the allegations contained in the complaint and are vigorously defending this lawsuit.

On January 29, 2018, the Bank was served with an amended complaint filed nominally against Berkshire Hills in the Business Litigation Session of the Massachusetts Superior Court sitting in Suffolk County. The amended complaint was filed by two residuary beneficiaries of an estate planning trust that was administered by the Bank as successor trustee following the death of the trust donor, and alleges the Bank breached its fiduciary duty and violated the Massachusetts Consumer Protection Act in the course of performing its duties as trustee. The complaint seeks compensatory, statutory, and punitive damages. Berkshire Hills and Berkshire Bank deny the allegations contained in the complaint and are vigorously defending this lawsuit.

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ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed below and in Part I, “Item 1A. Risk Factors” in our most recent Annual Report on Form 10-K, which could materially affect the Company's business, financial condition, or future operating results. The risks described in this form are not the only risks presently facing the Company. Additional risks and uncertainties not currently known to the Company, or currently deemed to be immaterial, also may materially adversely affect the Company's business, financial condition, and/or operating results. The integration of acquired Commerce acquisitions was completed during the first nine months of 2018. There were no other major changes in risk factors identified during this period.

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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

## (a) Recent Sales of Unregistered Securities

The Company occasionally engages in the practice of transferring unregistered securities for the purpose of completing business transactions. These shares are issued to vendors or other organizations as consideration for services performed in accordance with each contract. During the nine months ended September 30, 2018 and September 30, 2017, the Company transferred 1,437 and 8,038 shares, respectively.

(b) Not applicable.

(c) The following table provides certain information with regard to shares repurchased by the Company in the third quarter of 2018:

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
July 1-31, 2018	—	\$ —	—	500,000
August 1-31, 2018	—	—	—	500,000
September 1-30, 2018	—	—	—	500,000
Total	—	\$ —	—	500,000

On December 2, 2015, the Company announced that its Board of Directors authorized a new stock repurchase program, pursuant to which the Company may repurchase up to 500 thousand shares of the Company's common stock, representing approximately 1.6% of the Company's then outstanding shares. The timing of the purchases will depend on certain factors, including but not limited to, market conditions and prices, available funds, and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions or pursuant to a trading plan adopted in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934. Any repurchased shares will be recorded as treasury shares. The repurchase plan will continue until it is completed or terminated by the Board of Directors. As of September 30, 2018, no shares had been purchased under this program, and the available shares represented approximately 1.1% of outstanding shares at that date.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

- 3.1 Amended and Restated Certificate of Incorporation of Berkshire Hills Bancorp, Inc.(1)
- 3.2 Amended and Restated Bylaws of Berkshire Hills Bancorp, Inc. (2)
- 4.1 Form of Common Stock Certificate of Berkshire Hills Bancorp, Inc. (3)
- 4.2 Certificate of Designations of Series B Non-Voting Preferred Stock of Berkshire Hills Bancorp, Inc. (4)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 Shareholder Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements tagged as blocks of text and in detail.

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(1) Incorporated herein by reference from the Exhibits to the Form 10-Q as filed on August 9, 2018.

(2) Incorporated herein by reference from the Exhibits to the Form 8-K as filed on June 26, 2017.

(3) Incorporated herein by reference from the Exhibits to the Form S-1, Registration Statement and amendments thereto, initially filed on March 10, 2000, Registration No. 333-32146.

(4) Incorporated herein by reference from the Exhibits to the Form 8-K as filed on October 16, 2017.

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SIGNATURES

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

BERKSHIRE HILLS  
BANCORP, INC.

Dated: November 9, 2018 By: /s/ Michael P. Daly  
Michael P. Daly  
Chief Executive Officer

Dated: November 9, 2018 By: /s/ James M. Moses  
James M. Moses  
Senior Executive Vice  
President, Chief  
Financial Officer