
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**
FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2021

or

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

For the transition period from _____ to _____

Commission File Number 001-35272

MIDLAND STATES BANCORP, INC.

(Exact name of registrant as specified in its charter)

Illinois

(State of other jurisdiction of incorporation or organization)

37-1233196

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

1201 Network Centre Drive

62401

Effingham, IL

(Zip Code)

(Address of principal executive offices)

(217) 342-7321

(Registrant's telephone number, including area code)

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

| Title of each class | Trading symbol(s) | Name of each exchange on which registered |
|--------------------------------|--------------------------|--------------------------------------------------|
| Common Stock, \$0.01 par value | MSBI | Nasdaq Global Select Market |

Securities registered pursuant to Section 12(g) of the Act: **None**

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (\$232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

Emerging growth company

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

The aggregate market value of the Registrant's voting and non-voting common equity held by non-affiliates on June 30, 2021 was \$566,736,176 (based on the closing price on the Nasdaq Global Select Market on that date of \$26.27).

As of February 15, 2022, the Registrant had 22,031,410 shares of outstanding common stock, \$0.01 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held May 2, 2022, to be filed within 120 days after December 31, 2021, are incorporated by reference into Part III of this Form 10-K to the extent indicated in such part.

MIDLAND STATES BANCORP, INC.
2021 ANNUAL REPORT ON FORM 10-K
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Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

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

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

- business, economic and political conditions, particularly those affecting the financial services industry and our primary market areas;
- our ability to successfully manage our credit risk and the sufficiency of our allowance for credit losses on loans;
- the failure of assumptions and estimates underlying the establishment of our allowances for credit losses on loans, and estimation of values of collateral and various financial assets and liabilities;
- factors that can impact the performance of our loan portfolio, including real estate values and liquidity in our primary market areas, the financial health of our commercial borrowers and the success of construction projects that we finance, including any loans acquired in acquisition transactions;
- the effects of interest rates, including on our net interest income and the value of our securities portfolio;
- the effects of the Coronavirus Disease (“COVID”) pandemic and its potential effects on the economic environment, our customers and our operations, as well as any changes to the federal, state or local government laws, regulations or orders in connection with the pandemic;
- compliance with governmental and regulatory requirements, particularly those relating to banking, consumer protection, securities and tax matters, and our ability to maintain licenses required in connection with commercial mortgage origination, sale and servicing operations;
- legislative and regulatory changes, including changes in banking, consumer protection, securities, trade and tax laws and regulations and their application by our regulators;
- our ability to identify and address cyber-security risks, fraud and systems errors;
- our ability to effectively execute our strategic plan and manage our growth;
- the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services, including financial technology (“FinTech”) companies, and demand for financial services in our market areas;
- risks related to our acquisition strategy, including our ability to identify suitable acquisition candidates, exposure to potential asset and credit quality risks and unknown or contingent liabilities, the time and costs of integrating systems, procedures and personnel, the need for capital to finance such transactions, and possible failures in realizing the anticipated benefits from acquisitions;
- the effects of the accounting treatment for loans acquired in connection with our acquisitions;
- changes in our senior management team and our ability to attract, motivate and retain qualified personnel;
- monetary and fiscal policies of the U.S. government, including policies of the U.S. Department of the Treasury (“Treasury”) and the Board of Governors of the Federal Reserve System (the “Federal Reserve”);
- developments related to the replacement of the London Inter-Bank Offered Rate (“LIBOR”), and the adoption of a substitute reference rate;

- liquidity issues, including fluctuations in the fair value and liquidity of the securities we hold for sale and our ability to raise additional capital, if necessary;
- changes in federal tax law or policy;
- the quality and composition of our loan and investment portfolios and the valuation of our investment portfolio;
- demand for loan products and deposit flows;
- the costs, effects and outcomes of existing or future litigation;
- changes in accounting principles, policies and guidelines; and
- the effects of severe weather, natural disasters, acts of war or terrorism, widespread disease or pandemics, and other external events.

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

PART I

ITEM 1 – BUSINESS

Our Company

Midland States Bancorp, Inc. (the “Company,” “we,” “our,” or “us”), an Illinois corporation formed in 1988, is a diversified financial holding company headquartered in Effingham, Illinois. Our banking subsidiary, Midland States Bank (the “Bank”), an Illinois state-chartered bank formed in 1881, has branches across Illinois and in Missouri, and provides a full range of commercial and consumer banking products and services, business equipment financing, merchant credit card services, trust and investment management, and insurance and financial planning services. As of December 31, 2021, the Company had total assets of \$7.44 billion, and our wealth management group had assets under administration of approximately \$4.22 billion.

Prior to August 28, 2020, we provided multifamily and healthcare facility Federal Housing Administration (“FHA”) financing through Love Funding Corporation (“Love Funding”), our non-bank subsidiary. On August 28, 2020, the Company completed the sale of Love Funding’s commercial FHA origination platform to Dwight Capital, a nationwide mortgage banking firm headquartered in New York. The transaction was part of the Company’s ongoing effort to enhance efficiency and reduce volatility in its financial performance.

Our strategic plan is focused on building a performance-based, customer-centric culture, creating revenue diversification, seeking accretive acquisitions, achieving operational excellence and maintaining a robust enterprise-wide risk management program. Over the past several years, we have grown organically and through a series of acquisitions, with an over-arching focus on enhancing shareholder value and building a platform for scalability. Most recently, in June 2021, the Company completed its acquisition of substantially all of the trust assets of ATG Trust Company (“ATG Trust”), a trust company based in Chicago, Illinois. In July 2019, the Company completed its acquisition of HomeStar Financial Group, Inc. (“HomeStar”) and its wholly-owned banking subsidiary, HomeStar Bank and Financial Services (“HomeStar Bank”). Additional information on recent acquisitions is presented in Note 2 to the consolidated financial statements in Item 8 of this Form 10-K.

Our Principal Businesses

Traditional Community Banking. Our traditional community banking business primarily consists of commercial and retail lending and deposit taking. We deliver a comprehensive range of banking products and services to individuals, businesses, municipalities and other entities within our market areas, which include Illinois and the St. Louis metropolitan area, where we operated 52 full-service banking offices as of December 31, 2021.

Our lending strategy is to maintain a broadly diversified loan portfolio based on the type of customer (i.e., businesses versus individuals), type of loan product (e.g., owner occupied commercial real estate, commercial loans, agricultural loans, etc.), geographic location and industries in which our business customers are engaged (e.g., manufacturing, retail, hospitality, etc.). We principally focus our commercial lending activities on loans that we originate from borrowers located in our market areas.

We market our lending products and services to qualified lending customers primarily through branch offices and high touch personal service. We focus our business development and marketing strategy primarily on middle market businesses. Our primary products and services include the following:

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

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

Construction and Land Development Loans. Our construction portfolio includes loans to small and midsized businesses to construct owner-user properties, loans to developers of commercial real estate investment properties and residential developments and, to a lesser extent, loans to individual clients for construction of single family homes in our market areas. These loans are typically disbursed as construction progresses and carry interest rates that may vary with LIBOR through December 31, 2021, after which a successor index to LIBOR will be in place.

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

Consumer Installment Loans. We provide consumer installment loans for the purchase of cars, boats and other recreational vehicles, as well as for the purchase of major appliances and other home improvement projects. Our major appliance and other home improvement lending is originated principally through national and regional retailers and other vendors of these products and services. We typically use GreenSky Inc., a third party servicer, for our national and regional home improvement loans. On September 15, 2021, The Goldman Sachs Group, Inc. and GreenSky, Inc. announced that they had entered into a definitive agreement pursuant to which Goldman Sachs will acquire GreenSky. Based on recent discussions with GreenSky, we expect to remain in the GreenSky program at least through 2023. During this time, we will continue to originate loans through the GreenSky program with the plan to replace the level of payoffs that we experience and keep the portfolio relatively stable. After the new loan originations end, we expect that approximately 50% of the portfolio would run off over the first 12 months with the remainder paying off over several years.

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

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

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

FHA Servicing. Prior to the sale of Love Funding’s commercial FHA origination platform to Dwight Capital in August 2020, we conducted our FHA origination business through Love Funding. Until August 2020, Love Funding originated commercial mortgage loans for multifamily and healthcare facilities under FHA insurance programs, and sold those loans into the secondary market through mortgage-backed securities guaranteed by the Government National Mortgage Association (“Ginnie Mae”). The Bank continues to service Love Funding’s current servicing portfolio.

Competition

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

The following table reflects information on the markets we currently serve:

| (dollars in thousands) | | | June 30, 2021 | December 31, 2021 |
|------------------------|-------|-----------|---------------|----------------------|
| County | State | Deposits | Market Share | # of Banking Offices |
| Winnebago | IL | \$922,952 | 12.97% | 7 |
| Kankakee | IL | 709,498 | 29.16 | 8 |
| Effingham | IL | 627,255 | 28.98 | 1 |
| St. Charles | MO | 529,292 | 5.90 | 2 |
| LaSalle | IL | 382,005 | 11.64 | 4 |
| St. Louis | MO | 336,059 | 0.72 | 6 |
| Lee | IL | 259,169 | 28.97 | 1 |
| Boone | IL | 244,976 | 31.06 | 2 |
| Will | IL | 219,531 | 1.21 | 3 |
| Whiteside | IL | 203,666 | 10.52 | 2 |
| Bureau | IL | 171,454 | 14.67 | 1 |
| Kendall | IL | 106,436 | 5.24 | 2 |
| Grundy | IL | 93,363 | 5.95 | 1 |
| Monroe | IL | 87,080 | 7.82 | 2 |
| Marion | IL | 76,986 | 7.74 | 1 |
| Fayette | IL | 48,757 | 9.36 | 2 |
| Champaign | IL | 46,433 | 0.68 | 1 |
| Jefferson | MO | 41,742 | 1.23 | 1 |
| St. Clair | IL | 38,953 | 0.75 | 1 |
| Franklin | MO | 38,383 | 1.24 | 1 |
| Bond | IL | 34,562 | 8.74 | 1 |
| Livingston | IL | 21,647 | 1.64 | 1 |
| St. Louis (City) | MO | 1,668 | — | 1 |

Human Capital Resources

At December 31, 2021, we had 907 employees, including 43 part-time employees. Our employees are not represented by any collective bargaining group. Management considers its employee relations to be good. We believe our ability to attract and retain employees is a key to our success. Accordingly, we strive to offer competitive salaries and employee benefits to all employees and monitor salaries in our market areas.

In addition, we are committed to developing our staff through continuing and specialty education within banking. In this regard, we have developed and provided all employees with access to our Midland University training program. This program was developed to provide continuing education required or advisable regarding regulatory matters (such as anti-money laundering, bank secrecy, etc.) as well as other matters important to our organization and culture (e.g., social inclusion, diversity

and non-discrimination, etc.). Additionally, our Midland University program provides for continuing education in areas specifically related to our banking and financial services business.

Leadership and professional development is also supported through our MASTERS and Midland WOMEN groups. Our MASTERS programs, Midland's Advanced Study for Talent Enrichment and Resource Strengthening, were created to accelerate the career development of employees exhibiting the growth potential and qualities necessary to ensure the continued success of our Company. A total of 60 employees have participated in this high potential training program since its inception in 2016. Midland WOMEN is an affinity group that focuses on leadership development of women throughout all levels of the organization. Midland WOMEN currently has more than 25 employees participating on various activity committees and offers programs that engage hundreds of Midland employees annually.

Corporate Information

Our principal executive offices are located at 1201 Network Centre Drive, Effingham, Illinois 62401, and our telephone number at that address is (217) 342-7321. Through our website at www.midlandsb.com under "Investors - SEC Filings," we make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission (the "SEC"). The contents of our website are not incorporated by reference into this report.

Supervision and Regulation

General

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

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of FDIC-insured institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than shareholders. These laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of the Company's business, the kinds and amounts of investments the Company and the Bank may make, required capital levels relative to assets, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with the Company's and the Bank's insiders and affiliates and the Company's payment of dividends. In reaction to the global financial crisis and particularly following the passage of the Dodd Frank Act, the Company experienced heightened regulatory requirements and scrutiny. Although the reforms primarily targeted systemically important financial service providers, their influence filtered down in varying degrees to community banks over time and caused the Company's compliance and risk management processes, and the costs thereof, to increase. However, in May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act ("Regulatory Relief Act") was enacted by Congress in part to provide regulatory relief for community banks and their holding companies. To that end, the law eliminated questions about the applicability of certain Dodd-Frank Act reforms to community bank systems, including relieving the Company of any requirement to engage in mandatory stress tests, maintain a risk committee or comply with the Volcker Rule's complicated prohibitions on proprietary trading and ownership of private funds. The Company believes these reforms are favorable to its operations.

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

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and its subsidiary bank, beginning with a discussion of the impact of the COVID pandemic on the banking industry.

It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

COVID Pandemic

The federal bank regulatory agencies, along with their state counterparts, have issued a steady stream of guidance responding to the COVID pandemic and have taken a number of unprecedented steps to help banks navigate the pandemic and mitigate its impact. These include, without limitation: requiring banks to focus on business continuity and pandemic planning; adding pandemic scenarios to stress testing; encouraging bank use of capital buffers and reserves in lending programs; permitting certain regulatory reporting extensions; reducing margin requirements on swaps; permitting certain otherwise prohibited investments in investment funds; issuing guidance to encourage banks to work with customers affected by the pandemic and encourage loan workouts; and providing credit under the Community Reinvestment Act ("CRA") for certain pandemic-related loans, investments and public service. Moreover, because of the need for social distancing measures, the agencies revamped the manner in which they conducted periodic examinations of their regulated institutions, including making greater use of off-site reviews.

The Federal Reserve issued guidance encouraging banking institutions to utilize its discount window for loans and intraday credit extended by its Reserve Banks to help households and businesses impacted by the pandemic and announced numerous funding facilities. The FDIC also has acted to mitigate the deposit insurance assessment effects of participating in the Paycheck Protection Program ("PPP") administered through the Small Business Administration ("SBA") and the Federal Reserve's PPP Liquidity Facility and Money Market Mutual Fund Liquidity Facility.

Reference is made to the COVID discussion under "Operational, Strategic and Reputational Risks" under Item 1A - "Risk Factors" and "Material Trends and Developments - Impact of COVID" under Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations" for information on the CARES Act, PPP program and the Federal Reserve's lending facilities and for discussions of the economic impact of the COVID pandemic. In addition, information as to selected topics, such as the impact on capital requirements, dividend payments, reserves and CRA, is contained in the relevant sections of this Supervision and Regulation discussion provided below.

The Role of Capital

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

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

The Basel International Capital Accords. The risk-based capital guidelines for U.S. banks since 1989 were based upon the 1988 capital accord known as "Basel I" adopted by the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors that acts as the primary global standard-setter for prudential regulation, as implemented by the U.S. bank regulatory agencies on an interagency basis. The accord recognized that bank assets for the purpose of the capital ratio calculations needed to be assigned risk weights (the theory being that riskier assets should require more capital) and that off-balance sheet exposures needed to be factored in the calculations. Basel I had a very simple formula for assigning risk weights to bank assets from 0% to 100% based on four categories. In 2008, the banking agencies collaboratively began to

phase-in capital standards based on a second capital accord, referred to as “Basel II,” for large or “core” international banks (generally defined for U.S. purposes as having total assets of \$250 billion or more, or consolidated foreign exposures of \$10 billion or more) known as “advanced approaches” banks. The primary focus of Basel II was on the calculation of risk weights based on complex models developed by each advanced approaches bank. Because most banks were not subject to Basel II, the U.S. bank regulators worked to improve the risk sensitivity of Basel I standards without imposing the complexities of Basel II. This “standardized approach” increased the number of risk-weight categories and recognized risks well above the original 100% risk weight. It is institutionalized by the Dodd-Frank Act for all banking organizations, even for the advanced approaches banks, as a floor.

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

The Basel III Rule. In July 2013, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act (the “Basel III Rule”). In contrast to capital requirements historically, which were in the form of guidelines, Basel III was released in the form of enforceable regulations by each of the regulatory agencies. The Basel III Rule is applicable to all banking organizations that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies, other than “small bank holding companies” (generally holding companies with consolidated assets of less than \$3 billion) and certain qualifying banking organizations that may elect a simplified framework (which the Company has not done.) Thus, the Company and the Bank are each currently subject to the Basel III Rule as described below.

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

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

The Basel III Rule requires minimum capital ratios as follows:

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

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain 2.5% in Common Equity Tier 1 Capital attributable to a capital conservation buffer. The purpose of the conservation buffer is to ensure that banking institutions maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the conservation buffer increases the minimum ratios depicted above to 7% for Common Equity Tier 1 Capital, 8.5% for Tier 1 Capital and 10.5% for Total Capital. The federal bank regulators released a joint statement in response to the COVID pandemic reminding the industry that capital and liquidity buffers were meant to give banks the means to support the economy in adverse situations, and that the agencies would support banks that use the buffers for that purpose if undertaken in a safe and sound manner.

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

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

- A Common Equity Tier 1 Capital ratio to risk-weighted assets of 6.5% or more;
- A ratio of Tier 1 Capital to total risk-weighted assets of 8% or more;
- A ratio of Total Capital to total risk-weighted assets of 10% or more; and
- A leverage ratio of Tier 1 Capital to total adjusted average quarterly assets of 5% or greater.

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

As of December 31, 2021: (i) the Bank was not subject to a directive from the Federal Reserve to increase its capital; and (ii) the Bank was well-capitalized, as defined by Federal Reserve regulations. As of December 31, 2021, the Company had regulatory capital in excess of the Federal Reserve’s requirements and met the Basel III Rule requirements to be well-capitalized. The Company is also in compliance with the capital conservation buffer.

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

Community Bank Capital Simplification. Community banks have long raised concerns with bank regulators about the regulatory burden, complexity, and costs associated with certain provisions of the Basel III Rule. In response, Congress provided an “off-ramp” for institutions, like the Company, with total consolidated assets of less than \$10 billion. Section 201 of the Regulatory Relief Act instructed the federal banking regulators to establish a single “Community Bank Leverage Ratio” (“CBLR”) of between 8 and 10%. Under the final rule, a community banking organization is eligible to elect the new framework if it has less than \$10 billion in total consolidated assets, limited amounts of certain assets and off-balance sheet exposures, and a CBLR greater than 9%. The bank regulatory agencies temporarily lowered the CBLR to 8% as a result of the COVID pandemic. Nevertheless, the Company has not currently determined to elect the CBLR, but it may elect the framework at any time.

Supervision and Regulation of the Company

General. The Company, as the sole shareholder of the Bank, is a bank holding company. As a bank holding company, the Company is registered with, and is subject to regulation supervision and enforcement by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the "BHCA"). The Company is legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is required to file with the Federal Reserve periodic reports of the Company's operations and such additional information regarding the Company and its subsidiaries as the Federal Reserve may require.

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

The BHCA generally prohibits the Company from acquiring direct or indirect ownership or control of 5% or more of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be "so closely related to banking ... as to be a proper incident thereto." This authority permits the Company to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage services. The BHCA does not place territorial restrictions on the domestic activities of nonbank subsidiaries of bank holding companies.

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

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

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

Dividend Payments. The Company's ability to pay dividends to the Company's shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As an Illinois corporation, the Company is subject to the limitations of the Illinois Business Corporations Act, as amended, which allows us to pay dividends unless, after such dividend, (i) the Company would not be able to pay its debts as they become due in the usual course of business or (ii) the Company's total assets would be less than the sum of the Company's total liabilities plus any



amount that would be needed if it were to be dissolved at the time of the dividend payment, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to the rights of the shareholders receiving the distribution.

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

Incentive Compensation. There have been a number of developments in recent years focused on incentive compensation plans sponsored by bank holding companies and banks, reflecting recognition by the bank regulatory agencies and Congress that flawed incentive compensation practices in the financial industry were one of many factors contributing to the global financial crisis. Layered on top of that are the abuses in the headlines dealing with product cross-selling incentive plans. The result is interagency guidance on sound incentive compensation practices.

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

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

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

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

Supervision and Regulation of the Bank

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

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured institutions pay insurance premiums at rates based on their risk classification. For institutions like the Bank that are not considered large and highly complex banking organizations, assessments are now based on examination ratings and financial ratios. The total base

assessment rates currently range from 1.5 basis points to 30 basis points. At least semi-annually, the FDIC updates its loss and income projections for the DIF and, if needed, increases or decreases the assessment rates, following notice and comment on proposed rulemaking. The assessment base against which an FDIC-insured institution's deposit insurance premiums paid to the DIF has been calculated since effectiveness of the Dodd-Frank Act based on its average consolidated total assets less its average tangible equity. This method shifted the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits.

The reserve ratio is the FDIC insurance fund balance divided by estimated insured deposits. The Dodd-Frank Act altered the minimum reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits. The reserve ratio reached 1.36% as of September 30, 2018, exceeding the statutory required minimum. As a result, the FDIC provided assessment credits to insured depository institutions, like the Bank, with total consolidated assets of less than \$10 billion for the portion of their regular assessments that contributed to growth in the reserve ratio between 1.15% and 1.35%. The FDIC applied the small bank credits for quarterly assessment periods beginning July 1, 2019. However, the reserve ratio fell to 1.30% in 2020 as a result of extraordinary insured deposit growth caused by an unprecedented inflow of more than \$1 trillion in estimated insured deposits in the first half of 2020 stemming mainly from the COVID pandemic. Although the FDIC could have ceased the small bank credits, it waived the requirement that the reserve ratio be at least 1.35% for full remittance of the remaining assessment credits, and it refunded all small bank credits as of September 30, 2020.

Supervisory Assessments. All Illinois-chartered banks are required to pay supervisory assessments to the DFPR to fund the operations of that agency. The amount of the assessment is calculated on the basis of the Bank's total assets.

During the year ended December 31, 2021, the Bank paid supervisory assessments to the DFPR totaling approximately \$475,000.

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

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

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

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Under Illinois banking law, Illinois-chartered banks generally may pay dividends only out of undivided profits. The DFPR may restrict the declaration or payment of a dividend by an Illinois-chartered bank, such as the Bank. The payment of dividends by any FDIC-insured institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and an FDIC-insured institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its capital requirements under applicable guidelines as of December 31, 2021. Notwithstanding the availability of funds for dividends, however, the Federal Reserve and the DFPR may prohibit the payment of dividends by the Bank if either or both determine such payment would constitute an unsafe or unsound practice. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends have to maintain 2.5% in Common Equity Tier 1 Capital attributable to the capital conservation buffer. See “—The Role of Capital” above.

State Bank Investments and Activities. The Bank is permitted to make investments and engage in activities directly or through subsidiaries as authorized by Illinois law. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are

not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines that the activity would not pose a significant risk to the DIF. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank.

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

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

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

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

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the FDIC-insured institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk. The key risk themes identified for 2020 before the COVID pandemic were: (i) elevated operational risk as banks adapt to an evolving technology environment and persistent cybersecurity risks, (ii) the need for banks to prepare for a cyclical change in credit risk while credit performance is strong, (iii) elevated interest rate risk due to lower rates continuing to compress net interest margins, and (iv) strategic risks from non-depository financial institutions, use of innovative and evolving technology, and progressive data analysis capabilities. Pandemic planning and business continuity are now important risk management issues as well. The Bank is expected to have active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls.

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

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

Transaction Account Reserves. Federal law requires FDIC-insured institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts) to provide liquidity. Reserves are maintained on deposit at the Federal Reserve Banks. The reserve requirements are subject to annual adjustment by the Federal Reserve, and, for 2020, the Federal Reserve had determined that the first \$16.9 million of otherwise reservable balances had a zero percent reserve requirement; for transaction accounts aggregating between \$16.9 million to \$127.5 million, the reserve requirement was 3% of those transaction account balances; and for net transaction accounts in excess of \$127.5 million, the reserve requirement was 10% of the aggregate amount of total transaction account balances in excess of \$127.5 million. However, in March 2020, in an unprecedented move, the Federal Reserve announced that the banking system had ample reserves, and, as reserve requirements no longer played a significant role in this regime, it reduced all reserve tranches to zero percent, thereby freeing banks from the reserve maintenance requirement. The action permits the Bank to loan or invest funds that were previously unavailable. The Federal Reserve has indicated that it expects to continue to operate in an ample reserves regime for the foreseeable future.

Community Reinvestment Act Requirements. The CRA requires the Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods. Federal regulators regularly assess the Bank's record of meeting the credit needs of its communities. Applications for acquisitions would also be affected by the evaluation of the Bank's effectiveness in meeting its CRA requirements. In a joint statement responding to the COVID pandemic, the bank regulatory agencies announced favorable CRA consideration for banks providing retail banking services and lending activities in their assessment areas, consistent with safe and sound banking practices, that are responsive to the needs of low- and moderate-income individuals, small businesses, and small farms affected by the pandemic. Those activities include waiving certain fees, easing restrictions on out-of-state and non-customer checks, expanding credit products, increasing credit limits for creditworthy borrowers, providing alternative service options, and offering prudent payment accommodations. The joint statement also provided favorable CRA consideration for certain pandemic-related community development activities.

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

Concentrations in Commercial Real Estate. Concentration risk exists when FDIC-insured institutions deploy too many assets to any one industry or segment. A concentration in commercial real estate is one example of regulatory concern. The interagency Concentrations in Commercial Real Estate (“CRE”) Lending, Sound Risk Management Practices guidance (“CRE Guidance”) provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. On December 18, 2015, the federal banking agencies issued a statement to reinforce prudent risk-management practices related to CRE lending, having observed substantial growth in many CRE asset and lending markets, increased competitive pressures, rising CRE concentrations in banks, and an easing of CRE underwriting standards. The federal bank agencies reminded FDIC-insured institutions to maintain underwriting discipline and exercise prudent risk-management practices to identify, measure, monitor, and manage the risks arising from CRE lending. In addition, FDIC-insured institutions must maintain capital commensurate with the level and nature of their CRE concentration risk. As of December 31, 2021, the Bank did not exceed these guidelines.

Consumer Financial Services. The historical structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of

consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB has examination and enforcement authority over providers with more than \$10 billion in assets. FDIC-insured institutions with \$10 billion or less in assets, like the Bank, continue to be examined by their applicable bank regulators.

Because abuses in connection with residential mortgages were a significant factor contributing to the financial crisis, many rules issued by the CFPB, as required by the Dodd-Frank Act, addressed mortgage and mortgage-related products, their underwriting, origination, servicing and sales. The Dodd-Frank Act significantly expanded underwriting requirements applicable to loans secured by 1-4 family residential real property and augmented federal law combating predatory lending practices. In addition to numerous disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower’s ability to repay, while also establishing a presumption of compliance for certain “qualified mortgages.”

The CFPB’s rules have not had a significant impact on the Bank’s operations, except for higher compliance costs.

Regulation of Affiliates

The Company operates one affiliate that is regulated by functional financial regulatory agencies. Midland Risk Management Company, Inc. is a captive insurance company organized under the laws of the state of Nevada and subject to regulation, supervision and enforcement by the state Department of Insurance.

ITEM 1A – RISK FACTORS

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

Credit Risks

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

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

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

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of nonpayment, risks resulting from uncertainties as to the future value of collateral and cash flows available to service debt and risks resulting from changes in economic and market conditions. We cannot guarantee that our credit underwriting and monitoring procedures will reduce these credit risks, and they cannot be expected to completely eliminate our credit risks. If the overall economic climate in the United States, generally, or our market areas, specifically, declines, our borrowers may experience difficulties in repaying their loans, and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision for credit losses on loans, which would cause our net income, return on equity and capital to decrease. We maintain our allowance for credit losses on loans at a level that management considers adequate to absorb expected credit losses on loans based on an analysis of our portfolio and market environment.

As of December 31, 2021, our allowance for credit losses on loans as a percentage of total loans was 0.98% and as a percentage of total nonperforming loans was 119.92%. Although management believed, as of such date, that the allowance for credit losses on loans was adequate to absorb losses on any existing loans that may become uncollectible, we may be required to take additional provisions for credit losses on loans in the future to further supplement the allowance for credit losses on loans, either due to management's decision to do so or because our banking regulators require us to do so. Our bank regulatory agencies will periodically review our allowance for credit losses on loans and the value attributed to nonaccrual loans or to real estate acquired through foreclosure and may require us to adjust our determination of the value for these items. These adjustments may adversely affect our business, financial condition and results of operations.

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

At December 31, 2021, approximately 45.0% of our loan portfolio was comprised of loans with real estate as a primary or secondary component of collateral. As a result, adverse developments affecting real estate values in our market areas could increase the credit risk associated with our real estate loan portfolio. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the area in which the real estate is located. Adverse changes affecting real estate values and the liquidity of real estate in one or more of our markets could increase the credit risk associated with our loan portfolio, significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses, which could result in losses that would adversely affect profitability. Such declines and losses would have a material adverse impact on our business, results of operations and growth prospects. In addition, if hazardous or toxic substances are found on properties pledged as collateral, the value of the real estate could be impaired. If we foreclose on and take title to such properties, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit our ability to use or sell the affected property.

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

Commercial loans represented 66.2% of our total loan portfolio at December 31, 2021. Commercial loans are often larger and involve greater risks than other types of lending. Because payments on such loans often depend on the successful operation or development of the property or business involved, repayment of such loans is often more sensitive than other types of loans to adverse conditions in the real estate market or the general business climate and economy. Accordingly, a downturn in the real estate market and a challenging business and economic environment may increase our risk related to commercial loans, particularly commercial real estate loans. Unlike residential mortgage loans, which generally are made on the basis of the borrowers' ability to make repayment from their employment and other income and which are secured by real property, the value of which tends to be more easily ascertainable, commercial loans typically are made on the basis of the borrowers' ability to make repayment from the cash flow of the commercial venture. Our operating commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the collateral underlying the loans. Most often, this collateral consists of accounts receivable, inventory and equipment. Inventory and equipment may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. If the cash flow from business operations is reduced, the borrower's ability to repay the loan may be impaired. Due to the larger average size of each commercial loan as compared with other loans such as residential loans, as well as collateral that is generally less readily-marketable, losses incurred on a small number of commercial loans could have a material adverse impact on our financial condition and results of operations.

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

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

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

Real estate construction loans comprised approximately 3.7% of our total loan portfolio as of December 31, 2021, and such lending involves additional risks because funds are advanced upon the security of the project, which is of uncertain value prior to its completion, and costs may exceed realizable values in declining real estate markets. Because of the uncertainties inherent in estimating construction costs and the realizable market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated or market values or rental rates decline, we may have inadequate security for the repayment of the loan upon completion of construction of the project. If we are forced to foreclose on a project prior to or at completion due to a default, we may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time while we attempt to dispose of it.

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

As of December 31, 2021, we had \$12.1 million of other real estate owned. Our other real estate owned portfolio consists of properties that we obtained through foreclosure or through an in-substance foreclosure in satisfaction of loans. Properties in our other real estate owned portfolio are recorded at the lower of the recorded investment in the loans for which the properties previously served as collateral or the "fair value," which represents the estimated sales price of the properties on the date acquired less estimated selling costs.

In response to market conditions and other economic factors, we may utilize alternative sale strategies other than orderly disposition as part of our other real estate owned disposition strategy, such as immediate liquidation sales. In this event,

as a result of the significant judgments required in estimating fair value and the variables involved in different methods of disposition, the net proceeds realized from such sales transactions could differ significantly from appraisals, comparable sales and other estimates used to determine the fair value of our other real estate owned properties.

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

Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans or other real estate owned, thereby adversely affecting our net income and returns on assets and equity, increasing our loan administration costs and adversely affecting our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its then-fair market value, which may result in a loss. These nonperforming loans and other real estate owned also increase our risk profile and the level of capital our regulators believe is appropriate for us to maintain in light of such risks. The resolution of nonperforming assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in nonperforming loans and nonperforming assets, our net interest income may be negatively impacted and our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

Operational, Strategic and Reputational Risks

The COVID pandemic, including variants of the coronavirus, has adversely affected the U.S. economy and our customers, which has had, and may continue to have, a material and adverse effect on our business, financial condition, results of operations and growth prospects.

The COVID pandemic, including variants of the coronavirus, continues to negatively impact the United States and the world. The spread of COVID and the responses of federal, state and local governments have negatively impacted the U.S. economy and our customers, including through periods of economic recession, volatile levels of unemployment, increased inflation, supply chain and labor shortages, and other trends, all of which have had and may continue to have an adverse effect on our business and operations.

In particular, these trends have, among other things, negatively impacted loan demand and our growth strategy, and increased the risk of delinquencies, defaults, foreclosures, and losses on our loans, particularly for our customers with exposure to the hospitality, hotel, restaurant, ground transportation, long-term healthcare and retail industries.

The ultimate impact of the pandemic is highly uncertain and subject to change, and even if after the pandemic subsides, we may continue to experience material adverse impacts to our business as a result of the global economic impact of the pandemic and related governmental and social responses.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Mortgage production, especially refinancing activity, declines in rising interest rate environments, and in a rising interest rate environment, there can be no assurance that our mortgage production will continue at current levels. Because we sell a substantial portion of the mortgage loans we originate, the profitability of our mortgage banking business also depends in large part on our ability to aggregate a high volume of loans and sell them in the secondary market at a gain. Thus, in addition to our dependence on the interest rate environment, we are dependent upon (i) the existence of an active secondary market and (ii) our ability to profitably sell loans or securities into that market. If our level of mortgage production declines, the profitability will depend upon our ability to reduce our costs commensurate with the reduction of revenue from our mortgage operations.

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

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

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

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

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

We are a community bank, and our reputation is one of the most valuable components of our business. Similarly, each of our subsidiaries operate in niche markets where reputation is critically important. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our

customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results and the value of our stock may be materially adversely affected.

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

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

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

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

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

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

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

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

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

Interest rates on the Company's and the Bank's financial instruments might be subject to change based on developments related to LIBOR, which could adversely impact the Company's revenue, expenses, and value of those financial instruments.

The United Kingdom's Financial Conduct Authority, the authority regulating LIBOR, along with various other regulatory bodies, announced plans to discontinue the publication of LIBOR, an index rate commonly referenced in financial instruments. We have exposure to LIBOR in various aspects of our business through our financial contracts. Instruments that may be impacted include loans, securities, and derivatives, among other financial contracts and subordinated notes indexed to LIBOR and that mature after December 31, 2021.

While there is no certainty as to what rate or rates may become accepted alternatives to LIBOR, the Alternative Reference Rates Committee, a steering committee comprised of U.S. financial market participants, selected by the Federal Reserve Bank of New York, started in May 2018 to publish the Secured Overnight Financing Rate ("SOFR") as an alternative to LIBOR. SOFR is a broad measure of the cost of overnight borrowings collateralized by Treasury securities that was selected by the Alternative Reference Rate Committee due to the depth and robustness of the U.S. Treasury repurchase market.

The market transition away from LIBOR to an alternative reference rate, such as SOFR, is complex and could have a range of adverse effects on our business, financial condition and results of operations. In particular, any such transition could:

- adversely affect the interest rates paid or received on, the revenue and expenses associate with, and the value of our floating-rate obligations, loans, deposits, subordinated debentures, derivatives, and other financial instruments tied to LIBOR rates, or other securities or financial arrangements given LIBOR's role in determining market interest rates globally;
- prompt inquiries or other actions from regulators in respect of our preparation and readiness for the replacement of LIBOR with an alternative reference rate;
- result in disputes, litigation or other actions with counterparties regarding the interpretation and enforceability of certain fallback language, or lack of fallback language, in LIBOR-based instruments; and
- require the transition to or development of appropriate systems and analytics to effectively transition our risk management processes from LIBOR-based products to those based on the applicable alternative pricing benchmark, such as SOFR.

The manner and impact of this transition, as well as the effect of these developments on our funding costs, loan and investment and trading securities portfolios, asset-liability management, and business, is uncertain.

Legal, Accounting and Compliance Risks

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

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

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

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

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

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

Some of the services we provide, such as wealth management services, require us to act as fiduciaries for our customers and others. From time to time, third parties make claims and take legal action against us pertaining to the

performance of our fiduciary responsibilities. If these claims and legal actions are not resolved in a manner favorable to us, we may be exposed to significant financial liability and/or our reputation could be damaged. Either of these results may adversely impact demand for our products and services or otherwise have a harmful effect on our business and, in turn, on our financial condition and results of operations.

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

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

We are subject to stringent capital requirements, and failure to comply with these requirements may impact dividend payments and limit our activities.

As a result of the implementation of the Basel III Rule, we are required to meet minimum capital requirements. The failure to meet applicable regulatory capital requirements of the Basel III Rule could result in one or more of our regulators placing limitations or conditions on our activities, including our growth initiatives, or restricting the commencement of new activities, and could affect customer and investor confidence, our costs of funds and FDIC insurance costs, our ability to pay dividends on our common stock, our ability to make acquisitions, and our business, results of operations and financial conditions, generally. In addition, banking institutions that do not maintain a capital conservation buffer, comprised of Common Equity Tier 1 Capital, of 2.5% above the regulatory minimum capital requirements face constraints on the payment of dividends, stock repurchases and discretionary bonus payments to executive officers based on the amount of the shortfall, unless prior regulatory approval is obtained. Accordingly, if the Bank or the Company fails to maintain the applicable minimum capital ratios and the capital conservation buffer, distributions by the Bank to the Company, or dividends or stock repurchases by the Company, may be prohibited or limited.

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

The Federal Reserve, the FDIC and the DFPR periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil money penalties, to fine or remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have an adverse effect on our business, financial condition and results of operations.

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

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

litigation. Such actions could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

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

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

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

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

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

The financial services industry, as well as the broader economy, may be subject to new legislation, regulation, and government policy.

At this time, it is difficult to predict the legislative and regulatory changes that will result from having a new President of the United States. The new administration and Congress may cause broad economic changes due to changes in governing ideology and governing style. New appointments to the Board of Governors of the Federal Reserve could affect monetary policy and interest rates, and changes in fiscal policy could affect broader patterns of trade and economic growth. Future legislation, regulation, and government policy could affect the banking industry as a whole, including our business and results of operations, in ways that are difficult to predict. In addition, our results of operations also could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

Market and Interest Rate Risks

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

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

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

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

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

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

Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. For example, fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise, which we expect to occur in 2022. Additional factors include, but are not limited to, rating agency downgrades of the securities or our own analysis of the value of the security, defaults by the issuer or individual mortgagors with respect to the underlying securities, and continued instability in the credit markets. Any of the foregoing factors could cause an other-than-temporary impairment in future periods and result in realized losses. The process for determining whether impairment is other-than-temporary usually requires difficult, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Because of changing economic and market conditions affecting interest rates, the financial condition of issuers of the securities and the performance of the underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our financial condition and results of operations.

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

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

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

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

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

Liquidity and Funding Risks

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

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and/or investment securities and from other sources could have a substantial negative effect on our liquidity. Our most important

source of funds consists of our customer deposits, including escrow deposits held in connection with our commercial mortgage servicing business. Such deposit balances can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff, or, in connection with our commercial mortgage servicing business, third parties for whom we provide servicing choose to terminate that relationship with us. If customers move money out of bank deposits and into other investments, we could lose a relatively low cost source of funds, which would require us to seek wholesale funding alternatives in order to continue to grow, thereby increasing our funding costs and reducing our net interest income and net income.

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

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

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

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

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

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

ITEM 1B – UNRESOLVED STAFF COMMENTS

None.

ITEM 2 – PROPERTIES

Our corporate headquarters office building is located at 1201 Network Centre Drive, Effingham, Illinois, 62401. We own our corporate headquarters office building, which was built in 2011 and also houses our primary operations center. We have additional operations centers located in St. Louis, Missouri and Rockford, Illinois, supporting our banking and wealth management businesses. At December 31, 2021, the Bank operated a total of 52 full-service banking centers, including 41 located in Illinois and 11 located in the St. Louis metropolitan area. Of these facilities, 43 were owned, and we leased 9 from unaffiliated third parties.

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

ITEM 3 – LEGAL PROCEEDINGS

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

ITEM 4 – MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Shareholders

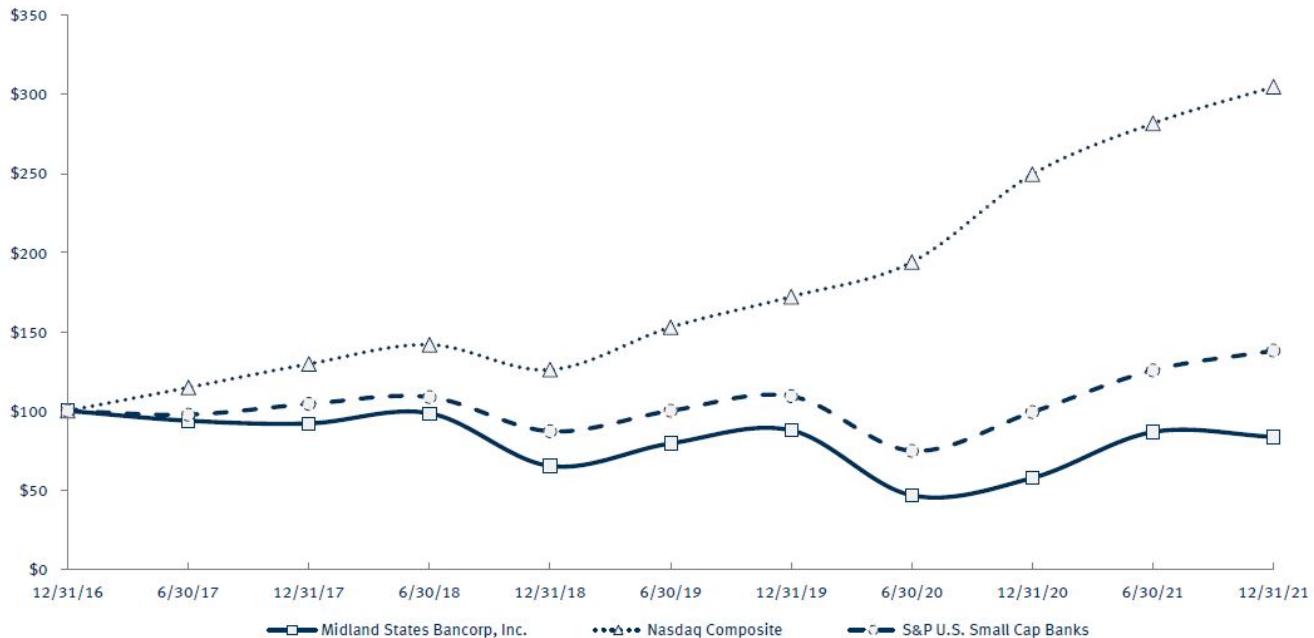
As of February 15, 2022, the Company had 924 common stock shareholders of record, and the closing price of the Company's common stock, traded on the Nasdaq Global Select Market ("Nasdaq") under the ticker symbol MSBI, was \$29.90 per share.

Stock Performance Graph

The following graph compares Company's five year cumulative shareholder returns with the Nasdaq Composite Index and the S&P U.S. Small Cap Banks Index. The graph assumes an investment of \$100.00 in the Company's common stock and each index on December 31, 2016 and reinvestment of all quarterly dividends. Measurement points are the last trading day of the second quarter and fourth quarter of each subsequent year through December 31, 2021. There is no assurance that the Company's common stock performance will continue in the future with the same or similar results as shown in the graph.

Comparison of Total Return Since 12/31/16

Among Midland States Bancorp, Inc., the Nasdaq Composite Index, and the S&P U.S. Small Cap Banks Index



Issuer Purchases of Equity Securities

The following table sets forth information regarding the Company's repurchase of shares of its outstanding common stock during the fourth quarter of 2021.

| Period | Total Number of Shares Purchased ⁽¹⁾ | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs ⁽²⁾ |
|-----------------------|-------------------------------------------------|------------------------------|----------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|
| October 1 - 31, 2021 | 205,015 | \$ 25.58 | 205,015 | \$ 19,673,699 |
| November 1 - 30, 2021 | 19,261 | 25.91 | — | 19,673,699 |
| December 1 - 31, 2021 | 242 | 24.08 | — | 19,673,699 |
| Total | <u><u>224,518</u></u> | <u><u>\$ 25.60</u></u> | <u><u>205,015</u></u> | <u><u>\$ 19,673,699</u></u> |

- (1) Represents shares of the Company's common stock repurchased under the employee stock purchase program, shares withheld to satisfy tax withholding obligations upon the vesting of awards of restricted stock and/or pursuant to a publicly announced repurchase plan or program, as discussed in footnote 2 below.
- (2) On August 6, 2019, the board of directors of the Company approved a stock repurchase program authorizing the Company to repurchase up to \$25.0 million of its common stock. On March 11, 2020, the Company announced that its Board of Directors authorized the Company to repurchase up to an additional \$25.0 million of its common stock in addition to the amount remaining under the prior authorization. On December 2, 2020, the Company announced that the Board had extended the expiration date of the repurchase program from December 31, 2020 to December 31, 2021. At the time of the extension, the program had approximately \$6.4 million of remaining repurchase authority. On September 7, 2021, the Company announced that the Board approved modifications to the Company's stock repurchase program, which increased the aggregate repurchase authority to \$75.0 million from \$50.0 million, and extended the expiration date of the program to December 31, 2022. At the time of the extension, the program had approximately \$1.3 million of remaining repurchase authority. Stock repurchases under these programs may be made from time to time on the open market, in privately negotiated transactions, or in any manner that complies with applicable securities laws, at the discretion of the Company. The timing of purchases and the number of shares repurchased under the programs are dependent upon a variety of factors including price, trading volume, corporate and regulatory requirements and market condition. The repurchase program may be suspended or discontinued at any time without notice. As of December 31, 2021, \$55.3 million, or 2,953,768 shares of the Company's common stock, had been repurchased under the program.

Unregistered Sales of Equity Securities

None.

ITEM 6 – [RESERVED]

ITEM 7 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes thereto, included in Item 8 - "Financial Statements and Supplementary Data", and other financial data appearing elsewhere in this report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Certain risks, uncertainties and other factors, including but not limited to those set forth under "Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995," Item 1A – "Risk Factors" and elsewhere in this report, may cause actual results to differ materially from those projected in the forward-looking statements. We assume no obligation to update any of these forward-looking statements. Readers of our Annual Report on Form 10-K should therefore consider these risks and uncertainties in evaluating forward-looking statements and should not place undue reliance on forward-looking statements.

Overview

Midland States Bancorp, Inc. is a diversified financial holding company headquartered in Effingham, Illinois. Its wholly-owned banking subsidiary, Midland States Bank, has branches across Illinois and in Missouri, and provides a full range of commercial and consumer banking products and services, business equipment financing, merchant credit card services, and trust and investment management services and insurance and financial planning services. As of December 31, 2021, we had assets of \$7.44 billion, deposits of \$6.11 billion and shareholders' equity of \$663.8 million.

Our strategic plan is focused on building a performance-based, customer-centric culture, creating revenue diversification, seeking accretive acquisitions, achieving operational excellence and maintaining a robust enterprise-wide risk management program. Over the past several years, we have grown organically and through a series of acquisitions, with an over-arching focus on enhancing shareholder value and building a platform for scalability. Most recently, on January 25, 2022, the Company announced the signing of a branch purchase and assumption agreement with FNBC Bank & Trust ("FNBC") whereby Midland has agreed to acquire the deposits and certain loans and other assets associated with FNBC's branches in Mokena and Yorkville, Illinois. We expect to acquire approximately \$86 million of deposits and approximately \$26 million of loans. The transaction is expected to close during the second quarter of 2022, subject to regulatory approval and other customary closing conditions. On June 1, 2021, the Company completed its acquisition of substantially all of the trust assets of ATG Trust, a trust company based in Chicago, Illinois. In July 2019, the Company completed its acquisition of HomeStar and its wholly-owned banking subsidiary, HomeStar Bank. Additional information on recent acquisitions is presented in Note 2 to the consolidated financial statements in Item 8 of this Form 10-K.

Our principal lines of business include traditional community banking and wealth management. Our traditional community banking business primarily consists of commercial and retail lending and deposit taking. Our wealth management group provides a comprehensive suite of trust and wealth management products and services, and has grown to \$4.22 billion of assets under administration as of December 31, 2021.

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

Material Trends and Developments

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

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

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

Credit Reserves. One of our key operating objectives has been, and continues to be, maintenance of an appropriate level of reserve protection against estimated losses in our loan portfolio. Our allowance for credit losses on loans totaled \$51.1 million, or 0.98% of total loans, and \$60.4 million, or 1.18% of total loans, at December 31, 2021 and 2020, respectively.

Effective January 1, 2020, the Company adopted CECL. The CECL model requires a reporting entity to estimate credit losses expected over the “life” of an asset, or pool of assets. The estimate of expected credit losses considers historical information, current information, and the reasonable and supportable forecasts of future events and circumstances, as well as estimates of prepayments. The allowance for credit losses (“ACL”) on loans and related provision for credit losses on loans was modeled under the provisions of CECL for the twelve months ended December 31, 2021 and 2020, as opposed to the incurred loss model for periods prior to January 1, 2020.

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

Impact of COVID. The progression of the COVID pandemic in the United States has had an adverse impact on our financial condition and results of operations as of and for the twelve months ended December 31, 2021 and 2020, and may continue to have a complex and adverse impact on the economy, the banking industry and our Company in future fiscal periods.

Effects on Our Business. The COVID pandemic, federal, state and local government responses to the pandemic, and the effects of the existing and future variants of the disease, including the Delta and Omicron variants, have had, and are expected to continue to have, a significant impact on our business. In particular, a significant portion of the Bank’s borrowers in the hotel, restaurant, ground transportation, long-term healthcare and retail industries have endured significant economic distress, which has adversely affected their ability to repay existing indebtedness and adversely impacted the value of collateral. These developments, together with economic conditions generally, are also expected to impact our commercial real estate portfolio, particularly with respect to real estate with exposure to these industries, our equipment leasing business and loan portfolio, our consumer loan business and loan portfolio, and the value of certain collateral securing our loans.

Our Response. We have taken numerous steps in response to the COVID pandemic, including the following:

- The Bank has granted requests for payment deferrals on loans related to the impact of COVID on such borrowers. At December 31, 2021, loans totaling \$13.3 million, or 0.3% of total loans, were on deferral. Deferrals of \$8.0 million related to assisted living facilities and \$3.1 million related to transit and ground transportation accounted for 83% of our deferrals at December 31, 2021. This is a significant improvement from December 31, 2020, when loans totaling \$209.1 million were on deferral. Deferrals of \$82.6 million related to the hotel and motel industry and \$44.1 million related to transit and ground transportation accounted for 61% of our deferrals at December 31, 2020. We are continuing to work with our customers to address their specific needs.
- The Bank participated as a lender in the PPP and began taking applications on the first day of the program. We funded \$418.2 million in PPP loans since its inception, and at December 31, 2021, we had \$52.5 million of PPP

loans outstanding to 535 customers. Income recognized on PPP loans totaled \$9.0 million, including net deferred fee accretion of \$7.6 million, in 2021 compared to income of \$7.1 million, including net deferred fee accretion of \$5.2 million, in 2020. The resulting PPP portfolio yield was 6.36% and 3.99% for the twelve months ended December 31, 2021 and 2020, respectively.

Additional Factors Affecting Comparability

Each factor listed below affects the comparability of our results of operations and financial condition in 2021 and 2020, and may affect the comparability of financial information we report in future fiscal periods.

FHLB Advance Prepayments. During 2021, the Company pre-paid FHLB advances of \$50.0 million in the first quarter, \$85.0 million in the second quarter and \$130.0 million in the fourth quarter. In the fourth quarter of 2020, the Company pre-paid \$114.2 million of FHLB advances. As a result, we paid prepayment fees of \$8.5 million in 2021 and \$4.9 million in 2020.

Tax Settlement. On June 29, 2021, the Company announced the settlement of a prior tax issue related to the treatment of gains recognized on FDIC-assisted transactions that resulted in a \$6.8 million tax benefit that was recognized in the second quarter of 2021. The Company also recognized approximately \$3.6 million in consulting and legal expenses related to the settlement of the tax issue, resulting in an after-tax gain of approximately \$2.9 million.

Redemption of Subordinated Notes. On June 18, 2021, the Company redeemed all of its outstanding fixed-to-floating rate subordinated notes due June 18, 2025, having an aggregate principal amount of \$31.1 million, in accordance with the terms of the notes. The aggregate redemption price was 100% of the aggregate principal amount of the subordinated notes, plus accrued and unpaid interest. The interest rate on the subordinated notes was 4.54%.

Recent Acquisitions. On June 1, 2021, the Company completed its acquisition of substantially all of the trust assets of ATG Trust, a trust company based in Chicago, Illinois, with \$399.7 million in assets under management.

Facilities Optimization Plan. The Company closed 13 branches, or 20% of its branch network, and vacated approximately 23,000 square feet of corporate office space between September 3, 2020 and December 31, 2020, recording \$12.7 million of asset impairment on existing banking facilities and \$0.8 million in other related charges. The branch and corporate office reductions resulted in cost savings of \$3.7 million in 2021. Additionally, the Company plans to renovate and upgrade five additional branches to reduce the size of and better utilize those facilities to serve retail and commercial customers. The timing and scope are under review as the Company evaluates the impact of supply chain pressures and building supply costs on these planned projects. We had facility-related assets classified as held for sale in other assets on the consolidated balance sheet of \$2.3 million and \$4.2 million at December 31, 2021 and 2020, respectively.

Sale of Commercial FHA Origination Platform. On August 28, 2020, the Company announced that it had completed the sale of its commercial FHA origination platform to Dwight Capital, a nationwide mortgage banking firm headquartered in New York.

Purchased Loans. Our net interest margin benefits from accretion income associated with purchase accounting discounts established on the purchased loans included in our acquisitions. Effective January 1, 2020, PCI loans were reclassified as purchased credit deteriorated ("PCD") loans, and due to this change, accretion income will decrease in future periods. Our reported net interest margins for 2021 and 2020 were 3.33% and 3.40%, respectively. Accretion income associated with accounting discounts established on loans acquired totaled \$4.3 million and \$7.7 million in 2021 and 2020, respectively, increasing the reported net interest margins by 7 and 13 basis points for each respective period.

Results of Operations

For discussion of the results of operations for the year ended December 31, 2020 compared with the year ended December 31, 2019, refer to Item 7 of the Company's 2020 Annual Report on Form 10-K, filed with the SEC on February 26, 2021, which is incorporated herein by reference.

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Overview. The following table sets forth condensed income statement information of the Company for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands, except per share data) | For the Years Ended December 31, | | |
|----------------------------------------------------|----------------------------------|------------|------------|
| | 2021 | 2020 | 2019 |
| Income Statement Data: | | | |
| Interest income | \$ 237,817 | \$ 244,888 | \$ 249,518 |
| Interest expense | 30,142 | 45,752 | 59,703 |
| Net interest income | 207,675 | 199,136 | 189,815 |
| Provision for credit losses | 3,393 | 44,361 | 16,985 |
| Noninterest income | 69,899 | 61,249 | 75,282 |
| Noninterest expense | 175,069 | 184,010 | 175,641 |
| Income before income taxes | 99,112 | 32,014 | 72,471 |
| Income taxes | 17,795 | 9,477 | 16,687 |
| Net income | 81,317 | 22,537 | 55,784 |
| Preferred stock dividends and premium amortization | — | — | 46 |
| Net income available to common shareholders | \$ 81,317 | \$ 22,537 | \$ 55,738 |
| Per Share Data: | | | |
| Basic earnings per share | \$ 3.58 | \$ 0.95 | \$ 2.28 |
| Diluted earnings per share | 3.57 | 0.95 | 2.26 |
| Performance Metrics: | | | |
| Return on average assets | 1.18 % | 0.35 % | 0.96 % |
| Return on average shareholders' equity | 12.65 | 3.55 | 8.74 |

In 2021, we generated net income of \$81.3 million, or diluted earnings per common share of \$3.57, compared to net income of \$22.5 million, or diluted earnings per common share of \$0.95 in 2020. Earnings in 2021 increased primarily due to an \$8.5 million increase in net interest income, a \$41.0 million decrease in provision for credit losses, an \$8.7 million increase in noninterest income and an \$8.9 million decrease in noninterest expense. These results were partially offset by an \$8.3 million increase in income tax expense. These are discussed in further detail below.

Net Interest Income and Margin. Our primary source of revenue is net interest income, which is the difference between interest income from interest-earning assets (primarily loans and securities) and interest expense of funding sources (primarily interest-bearing deposits and borrowings). Net interest income is influenced by many factors, primarily the volume and mix of interest-earning assets, funding sources, and interest rate fluctuations. Noninterest-bearing sources of funds, such as demand deposits and shareholders' equity, also support earning assets. The impact of the noninterest-bearing sources of funds is captured in net interest margin, which is calculated as net interest income divided by average interest-earning assets. Net interest margin is presented on a tax-equivalent basis, which means that tax-free interest income has been adjusted to pretax-equivalent income, assuming a federal income tax rate of 21% for 2021 and 2020.

In 2021, net interest income, on a tax-equivalent basis, increased to \$209.2 million with a tax-equivalent net interest margin of 3.33% compared to net interest income, on a tax-equivalent basis, of \$200.9 million and a tax-equivalent net interest margin of 3.40% in 2020.

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Average Balance Sheet, Interest and Yield/Rate Analysis. The following table presents average balance sheet information, interest income, interest expense and the corresponding average yields earned and rates paid for the years ended December 31, 2021, 2020 and 2019. The average balances are principally daily averages and, for loans, include both performing and nonperforming balances. Interest income on loans includes the effects of discount accretion and net deferred loan origination costs accounted for as yield adjustments.

| (tax-equivalent basis, dollars in thousands) | Year Ended December 31, | | | | | | | | |
|---------------------------------------------------------------------|-------------------------|-----------------|--------------|-----------------|-----------------|--------------|-----------------|-----------------|--------------|
| | 2021 | | | 2020 | | | 2019 | | |
| | Average Balance | Interest & Fees | Yield / Rate | Average Balance | Interest & Fees | Yield / Rate | Average Balance | Interest & Fees | Yield / Rate |
| EARNING ASSETS: | | | | | | | | | |
| Federal funds sold and cash investments | \$ 518,804 | \$ 728 | 0.14 % | \$ 433,965 | \$ 1,479 | 0.34 % | \$ 245,772 | \$ 4,951 | 2.01 % |
| <i>Investment securities:</i> | | | | | | | | | |
| Taxable investment securities | 646,079 | 13,898 | 2.15 | 533,985 | 14,789 | 2.77 | 502,557 | 14,690 | 2.92 |
| Investment securities exempt from federal income tax ⁽¹⁾ | 130,495 | 4,222 | 3.24 | 119,612 | 4,471 | 3.74 | 144,721 | 5,187 | 3.58 |
| Total securities | 776,574 | 18,120 | 2.33 | 653,597 | 19,260 | 2.95 | 647,278 | 19,877 | 3.07 |
| <i>Loans:</i> | | | | | | | | | |
| Loans ⁽²⁾ | 4,821,718 | 213,922 | 4.44 | 4,622,651 | 217,459 | 4.70 | 4,127,374 | 218,416 | 5.29 |
| Loans exempt from federal income tax ⁽¹⁾ | 81,730 | 3,127 | 3.83 | 99,173 | 3,937 | 3.97 | 105,436 | 4,549 | 4.31 |
| Total loans | 4,903,448 | 217,049 | 4.43 | 4,721,824 | 221,396 | 4.69 | 4,232,810 | 222,965 | 5.27 |
| Loans held for sale | 37,638 | 1,115 | 2.96 | 52,233 | 1,881 | 3.60 | 34,910 | 1,375 | 3.94 |
| Nonmarketable equity securities | 47,045 | 2,348 | 4.99 | 49,623 | 2,638 | 5.32 | 44,061 | 2,395 | 5.44 |
| Total earning assets | 6,283,509 | 239,360 | 3.81 | 5,911,242 | 246,654 | 4.17 | 5,204,831 | 251,563 | 4.83 |
| Noninterest-earning assets | 598,083 | | | 617,984 | | | 630,255 | | |
| Total assets | \$ 6,881,592 | | | \$ 6,529,226 | | | \$ 5,835,086 | | |
| INTEREST-BEARING LIABILITIES | | | | | | | | | |
| Checking and money market deposits | \$ 2,467,288 | \$ 3,020 | 0.12 % | \$ 2,330,657 | \$ 7,879 | 0.34 % | \$ 1,888,354 | \$ 14,390 | 0.76 % |
| Savings deposits | 655,735 | 164 | 0.02 | 567,398 | 245 | 0.04 | 489,270 | 892 | 0.18 |
| Time deposits | 690,558 | 7,373 | 1.07 | 712,344 | 12,760 | 1.79 | 767,583 | 15,470 | 2.02 |
| Brokered time deposits | 32,419 | 400 | 1.23 | 24,387 | 614 | 2.52 | 136,503 | 3,442 | 2.52 |
| Total interest-bearing deposits | 3,846,000 | 10,957 | 0.28 | 3,634,786 | 21,498 | 0.59 | 3,281,710 | 34,194 | 1.04 |
| Short-term borrowings | 68,986 | 86 | 0.12 | 60,306 | 178 | 0.30 | 121,168 | 835 | 0.69 |
| FHLB advances and other borrowings | 473,371 | 8,443 | 1.78 | 650,683 | 12,033 | 1.85 | 600,454 | 13,935 | 2.32 |
| Subordinated debt | 153,126 | 8,705 | 5.68 | 169,748 | 9,730 | 5.73 | 119,353 | 7,404 | 6.20 |
| Trust preferred debentures | 49,098 | 1,951 | 3.97 | 48,554 | 2,313 | 4.76 | 48,043 | 3,335 | 6.94 |
| Total interest-bearing liabilities | 4,590,581 | 30,142 | 0.66 | 4,564,077 | 45,752 | 1.00 | 4,170,728 | 59,703 | 1.43 |
| NONINTEREST-BEARING LIABILITIES | | | | | | | | | |
| Noninterest-bearing deposits | 1,568,005 | | | 1,255,031 | | | 959,363 | | |
| Other noninterest-bearing liabilities | 80,308 | | | 75,123 | | | 66,688 | | |
| Total noninterest-bearing liabilities | 1,648,313 | | | 1,330,154 | | | 1,026,051 | | |
| Shareholders' equity | 642,698 | | | 634,995 | | | 638,307 | | |
| Total liabilities and shareholders' equity | \$ 6,881,592 | | | \$ 6,529,226 | | | \$ 5,835,086 | | |
| Net interest income / net interest margin ⁽³⁾ | \$ 209,218 | 3.33 % | | \$ 200,902 | 3.40 % | | \$ 191,860 | 3.69 % | |

- (1) Interest income and average rates for tax-exempt loans and securities are presented on a tax-equivalent basis, assuming a statutory federal income tax rate of 21%. Tax-equivalent adjustments totaled \$1.5 million, \$1.8 million and \$2.0 million for the years ended December 31, 2021, 2020 and 2019, respectively.
- (2) Average loan balances include nonaccrual loans. Interest income on loans includes amortization of deferred loan fees, net of deferred loan costs.
- (3) Net interest margin during the periods presented represents: (i) the difference between interest income on interest-earning assets and the interest expense on interest-bearing liabilities, divided by (ii) average interest-earning assets for the period.

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

| (tax-equivalent basis, dollars in thousands) | Year Ended December 31, 2021 Compared with Year Ended December 31, 2020 | | | Year Ended December 31, 2020 Compared with Year Ended December 31, 2019 | | |
|------------------------------------------------------|-------------------------------------------------------------------------------|--------------------|----------------------|-------------------------------------------------------------------------------|--------------------|----------------------|
| | Change due to: | | Interest Variance | Change due to: | | Interest Variance |
| | Volume | Rate | | Volume | Rate | |
| INTEREST-EARNING ASSETS: | | | | | | |
| Federal funds sold & cash investments | \$ 203 | \$ (954) | \$ (751) | \$ 2,216 | \$ (5,688) | \$ (3,472) |
| Investment securities: | | | | | | |
| Taxable investment securities | 2,758 | (3,649) | (891) | 895 | (796) | 99 |
| Investment securities exempt from federal income tax | 379 | (628) | (249) | (919) | 203 | (716) |
| Total securities | <u>3,137</u> | <u>(4,277)</u> | <u>(1,140)</u> | <u>(24)</u> | <u>(593)</u> | <u>(617)</u> |
| Loans: | | | | | | |
| Loans | 9,098 | (12,635) | (3,537) | 24,754 | (25,711) | (957) |
| Loans exempt from federal income tax | (679) | (131) | (810) | (259) | (353) | (612) |
| Total loans | <u>8,419</u> | <u>(12,766)</u> | <u>(4,347)</u> | <u>24,495</u> | <u>(26,064)</u> | <u>(1,569)</u> |
| Loans held for sale | (479) | (287) | (766) | 653 | (147) | 506 |
| Nonmarketable equity securities | (133) | (157) | (290) | 299 | (56) | 243 |
| Total earning assets | <u>\$ 11,147</u> | <u>\$ (18,441)</u> | <u>\$ (7,294)</u> | <u>\$ 27,639</u> | <u>\$ (32,548)</u> | <u>\$ (4,909)</u> |
| INTEREST-BEARING LIABILITIES: | | | | | | |
| Checking and money market deposits | \$ 314 | \$ (5,173) | \$ (4,859) | \$ 2,432 | \$ (8,944) | \$ (6,512) |
| Savings deposits | 31 | (112) | (81) | 88 | (735) | (647) |
| Time deposits | (312) | (5,075) | (5,387) | (1,051) | (1,659) | (2,710) |
| Brokered time deposits | 151 | (365) | (214) | (2,824) | (3) | (2,827) |
| Total interest-bearing deposits | <u>184</u> | <u>(10,725)</u> | <u>(10,541)</u> | <u>(1,355)</u> | <u>(11,341)</u> | <u>(12,696)</u> |
| Short-term borrowings | 19 | (111) | (92) | (300) | (357) | (657) |
| FHLB advances and other borrowings | (3,221) | (369) | (3,590) | 1,047 | (2,949) | (1,902) |
| Subordinated debt | (949) | (76) | (1,025) | 3,007 | (681) | 2,326 |
| Trust preferred debentures | 24 | (386) | (362) | 30 | (1,052) | (1,022) |
| Total interest-bearing liabilities | <u>\$ (3,943)</u> | <u>\$ (11,667)</u> | <u>\$ (15,610)</u> | <u>\$ 2,429</u> | <u>\$ (16,380)</u> | <u>\$ (13,951)</u> |
| Net interest income | <u>\$ 15,090</u> | <u>\$ (6,774)</u> | <u>\$ 8,316</u> | <u>\$ 25,210</u> | <u>\$ (16,168)</u> | <u>\$ 9,042</u> |

Interest Income. Interest income, on a tax-equivalent basis, decreased \$7.3 million to \$239.4 million in 2021 as compared to 2020 primarily due to a decrease in the yields on all earning asset categories. The yield on earning assets decreased 36 basis points to 3.81% from 4.17%. The decrease in yield on earning assets was primarily due to the impact of lower market interest rates and a reduction in accretion income associated with accounting discounts established on loans acquired, which totaled \$4.3 million and \$7.7 million in 2021 and 2020, respectively.

Average earning assets increased to \$6.28 billion in 2021 from \$5.91 billion in 2020. Increases in average loans and investment securities of \$181.6 million and \$123.0 million, respectively, accounted for the majority of the \$372.3 million increase in average earning assets. Average commercial loans and consumer loans increased \$124.1 million and \$119.3 million, respectively, for the twelve months ended December 31, 2021 compared to the same period of 2020. Increases in commercial FHA warehouse lines accounted for \$73.7 million of the increase in average commercial loan balances. PPP loan balances averaged \$141.3 million in 2021, generated income of \$9.0 million and yielded 6.36%. In 2020, the PPP loan portfolio averaged \$235.6 million, generated income of \$7.1 million and yielded 3.99%. The average balance of our residential real estate portfolio decreased by \$135.5 million in 2021 compared to 2020 due to payoffs and scheduled repayments.

Interest Expense. Interest expense decreased \$15.6 million to \$30.1 million in 2021 compared to 2020. The cost of interest-bearing liabilities decreased to 0.66% in 2021 compared to 1.00% for the prior year primarily due to the continued reduction in rates paid on interest-bearing deposit accounts.

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Interest expense on deposits decreased to \$11.0 million in 2021 from \$21.5 million in 2020. The decrease was primarily due to a decrease in rates paid on deposits. Average balances of interest-bearing deposit accounts increased \$211.2 million, or 5.8%, to \$3.85 billion for the year ended December 31, 2021 compared to 2020. The increase in volume was primarily attributable to increases of retail deposits, commercial deposits and from our Insured Cash Sweep product offering of \$83.2 million, \$65.0 million and \$64.9 million, respectively.

Interest expense on FHLB advances and other borrowings decreased \$3.6 million for the year ended December 31, 2021, from the comparable period in 2020. Average balances decreased \$177.3 million in 2021 compared to 2020, due in large part to the Company prepaying \$265.0 million of longer term FHLB advances during the year.

Interest expense on subordinated debt decreased \$1.0 million in 2021 from 2020 primarily due to the redemption of \$31.1 million of subordinated debt on June 18, 2021. The interest rate on the redeemed subordinated notes was 4.54%.

Provision for Credit Losses. The Company's provision for credit losses was \$3.4 million in 2021. The provision for credit losses on loans was \$4.0 million, partially offset by the recognition of expense reversals of \$0.4 million and \$0.1 million related to unfunded loan commitments and investment securities, respectively. Provision expense recognized in 2020 totaled \$44.4 million, with \$43.1 million attributable to loans, \$0.8 million related to unfunded loan commitments and \$0.4 million related to investment securities. The decrease in the provision for credit losses on loans in 2021 compared to prior year was primarily due to lower net charge-offs, favorable changes in the mix of our loan portfolio and improved economic forecasts as a result of increasing immunization rates and the lifting of restrictions on businesses by states and municipalities.

The provision for credit losses on loans recognized during 2021 and 2020 was made at a level deemed necessary by management to absorb estimated losses in the loan portfolio. A detailed evaluation of the adequacy of the allowance for credit losses is completed quarterly by management, the results of which are used to determine provision for credit losses. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and reasonable and supportable forecasts along with other qualitative and quantitative factors.

Noninterest Income. The following table sets forth the major components of our noninterest income for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | For the Year Ended December 31, | | | 2021 Compared to 2020 | | 2020 Compared to 2019 | |
|----------------------------------------------------|---------------------------------|-----------|-----------|-----------------------|--------|-----------------------|---------|
| | 2021 | 2020 | 2019 | | | | |
| <i>Noninterest income:</i> | | | | | | | |
| Wealth management revenue | \$ 26,811 | \$ 22,802 | \$ 21,832 | \$ 4,009 | 17.6 % | \$ 970 | 4.4 % |
| Commercial FHA revenue | 1,414 | 6,007 | 15,309 | (4,593) | (76.5) | (9,302) | (60.8) |
| Residential mortgage banking revenue | 5,526 | 9,812 | 2,928 | (4,286) | (43.7) | 6,884 | 235.1 |
| Service charges on deposit accounts | 8,348 | 8,603 | 11,027 | (255) | (3.0) | (2,424) | (22.0) |
| Interchange revenue | 14,500 | 12,266 | 11,992 | 2,234 | 18.2 | 274 | 2.3 |
| Gain on sales of investment securities, net | 537 | 1,721 | 674 | (1,184) | (68.8) | 1,047 | 155.3 |
| Impairment on commercial mortgage servicing rights | (7,532) | (12,337) | (2,139) | 4,805 | (38.9) | (10,198) | 476.8 |
| Company-owned life insurance | 4,496 | 3,581 | 3,640 | 915 | 25.6 | (59) | (1.6) |
| Other income | 15,799 | 8,794 | 10,019 | 7,005 | 79.7 | (1,225) | (12.2) |
| Total noninterest income | \$ 69,899 | \$ 61,249 | \$ 75,282 | \$ 8,650 | 14.1 % | \$ (14,033) | (18.6)% |

Wealth management revenue. Income from our wealth management business for 2021 totaled \$26.8 million as compared to \$22.8 million in the same period of 2020. Assets under administration increased to \$4.22 billion at December 31, 2021 from \$3.48 billion at December 31, 2020, primarily due to the addition of \$399.7 million of assets under administration from the acquisition of ATG Trust at June 1, 2021 and an increase in the market performance as a result of the economic recovery between the two periods.

Commercial FHA revenue. Commercial FHA revenue decreased \$4.6 million for the twelve months ended December 31, 2021, as compared to the same period in 2020. The decline in revenue was attributable to the sale of the loan origination platform in August 2020, resulting in a decline in interest rate locks.

Residential mortgage banking revenue. Residential mortgage banking revenue for 2021 totaled \$5.5 million, compared to \$9.8 million in 2020, primarily attributable to a decrease in production. Loans originated for sale into the secondary market

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in 2021 totaled \$211.6 million, with 46% representing refinance transactions versus purchase transactions. Similar loans originated during the prior year totaled \$296.5 million with 59% representing refinance transactions.

Interchange revenue. Interchange revenue totaled \$14.5 million in 2021 compared to \$12.3 million in 2020. Transaction volume increased due to an increase in the number of deposit transaction accounts opened in 2021 and continued increase in electronic payments volume.

Impairment of commercial mortgage servicing rights. Impairment of commercial mortgage servicing rights was \$7.5 million for 2021 compared to \$12.3 million for 2020. The impairment resulted from loan prepayments as borrowers refinanced their loans in the current low interest rate environment. Loans serviced for others totaled \$2.65 billion and \$3.50 billion at December 31, 2021 and 2020, respectively.

Company owned life insurance. In the fourth quarter of 2021, the Company recognized \$1.1 million of death benefits due to the passing of its former CEO and President.

Other noninterest income. Other income totaled \$15.8 million for 2021, an increase of \$7.0 million, as compared to 2020. In 2021, the Company recognized \$2.2 million of income on the termination of hedged interest rate swaps and \$4.2 million of unrealized income on equity investments in FinTech-related venture capital funds and SBIC limited partnerships.

Noninterest Expense. The following table sets forth the major components of noninterest expense for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | For the Year Ended December 31, | | | 2021 Compared to 2020 | | 2020 Compared to 2019 | |
|-----------------------------------------------|---------------------------------|------------|------------|-----------------------|---------|-----------------------|--------|
| | 2021 | 2020 | 2019 | Increase (decrease) | | Increase (decrease) | |
| <i>Noninterest expense:</i> | | | | | | | |
| Salaries and employee benefits | \$ 86,883 | \$ 85,557 | \$ 91,906 | \$ 1,326 | 1.5 % | \$ (6,349) | (6.9)% |
| Occupancy and equipment | 14,866 | 17,552 | 18,811 | (2,686) | (15.3) | (1,259) | (6.7) |
| Data processing | 24,595 | 22,643 | 21,390 | 1,952 | 8.6 | 1,253 | 5.9 |
| Professional | 10,971 | 7,234 | 8,783 | 3,737 | 51.7 | (1,549) | (17.6) |
| Marketing | 3,239 | 3,498 | 3,927 | (259) | (7.4) | (429) | (10.9) |
| Communications | 3,002 | 4,052 | 3,693 | (1,050) | (25.9) | 359 | 9.7 |
| Amortization of intangible assets | 5,855 | 6,504 | 7,090 | (649) | (10.0) | (586) | (8.3) |
| Impairment related to facilities optimization | — | 12,847 | 3,577 | (12,847) | (100.0) | 9,270 | 100.0 |
| FHLB advances prepayment fees | 8,536 | 4,872 | — | 3,664 | 100.0 | 4,872 | — |
| Other expense | 17,122 | 19,251 | 16,464 | (2,129) | (11.1) | 2,787 | 16.9 |
| Total noninterest expense | \$ 175,069 | \$ 184,010 | \$ 175,641 | \$ (8,941) | (4.9)% | \$ 8,369 | 4.8 % |

Salaries and employee benefits. Salaries and employee benefits expense for 2021 totaled \$86.9 million, compared to \$85.6 million in 2020, primarily due to higher incentive and bonus expense in 2021. The Company employed 907 employees at December 31, 2021 compared to 904 employees at December 31, 2020.

Occupancy and equipment expense. The \$2.7 million decrease in expense was primarily due to the Company operating fewer offices in 2021 compared to 2020. In the third quarter of 2020, we vacated the Love Funding offices as a result of the sale of the commercial FHA loan origination platform, and in December 2020, we closed 13 branches and vacated approximately 23,000 square feet of corporate office space. The Company operated 52 full-service banking centers at December 31, 2021.

Data processing fees. The \$2.0 million increase in data processing fees during 2021, as compared to 2020, was primarily the result of our continuing investments in technology to better serve our growing customer base.

Professional fees. The \$3.7 million increase in professional fees in 2021, as compared to 2020, was primarily the result of \$3.6 million of consulting and legal expenses incurred in the second quarter of 2021 related to the settlement of a tax issue.

Impairment on facilities optimization. In December 2020, the Company closed 13 branches and vacated approximately 23,000 square feet of corporate office space. As a result of that plan, we recorded \$12.7 million of asset impairment on existing banking facilities and \$0.8 million in other related charges.

FHLB advances prepayment fees. During 2021, the Company pre-paid FHLB advances of \$50.0 million in the first quarter, \$85.0 million in the second quarter and \$130.0 million in the fourth quarter. In the fourth quarter of 2020, the Company

pre-paid \$114.2 million of FHLB advances. As a result, we incurred prepayment fees of \$8.5 million in 2021 and \$4.9 million in 2020.

Other expense. Other expense decreased \$2.1 million as compared to 2020. The Company incurred higher expenses in 2020 compared to 2021 related to OREO expenses and impairment of mortgage servicing rights held for sale.

Income Tax Expense. Income tax expense was \$17.8 million in 2021 compared to \$9.5 million in 2020. Effective tax rates for 2021 and 2020 were 18.0% and 29.6%, respectively. The Company's income tax expense and related effective tax rate for 2021 benefited from the \$6.8 million in settlements related to the treatment of gains recognized on FDIC-assisted transactions discussed earlier. Tax expense and the effective tax rate for the comparable period of 2020 were negatively impacted by Love Funding's asset sale in the third quarter of 2020.

Financial Condition

Assets. Total assets increased to \$7.44 billion at December 31, 2021, as compared to \$6.87 billion at December 31, 2020.

Loans. The loan portfolio is the largest category of our assets. The following table presents the balance and associated percentage of each major category in our loan portfolio at December 31, 2021, 2020 and 2019:

| (dollars in thousands) | As of December 31, | | | | | |
|--------------------------------------|--------------------|--------|--------------|--------|--------------|--------|
| | 2021 | | 2020 | | 2019 | |
| | Book Value | % | Book Value | % | Book Value | % |
| Loans: | | | | | | |
| Commercial | \$ 1,450,188 | 27.8 % | \$ 1,685,575 | 33.0 % | \$ 1,055,185 | 24.0 % |
| Commercial real estate | 1,816,828 | 34.8 | 1,525,973 | 29.9 | 1,526,504 | 34.7 |
| Construction and land development | 193,749 | 3.7 | 172,737 | 3.4 | 208,733 | 4.7 |
| Total commercial loans | 3,460,765 | 66.2 | 3,384,285 | 66.3 | 2,790,422 | 63.4 |
| Residential real estate | 338,151 | 6.5 | 442,880 | 8.7 | 568,291 | 12.9 |
| Consumer | 1,002,605 | 19.2 | 866,102 | 17.0 | 710,116 | 16.1 |
| Lease financing | 423,280 | 8.1 | 410,064 | 8.0 | 332,581 | 7.6 |
| Total loans, gross | 5,224,801 | 100.0 | 5,103,331 | 100.0 | 4,401,410 | 100.0 |
| Allowance for credit losses on loans | (51,062) | | (60,443) | | (28,028) | |
| Total loans, net | \$ 5,173,739 | | \$ 5,042,888 | | \$ 4,373,382 | |

Loans totaled \$5.22 billion at December 31, 2021, an increase of \$121.5 million, or 2.4%, from one year prior. The loan growth was primarily reflected in our commercial real estate and consumer loan portfolios, which increased \$290.9 million and \$136.5 million, respectively. These increases were offset in part by payoffs and repayments in the residential real estate portfolio.

Commercial loans, which includes PPP loans and commercial FHA warehouse lines, decreased \$235.4 million to \$1.45 billion at December 31, 2021 as compared to December 31, 2020. PPP loans at December 31, 2021 totaled \$52.5 million, a decrease of \$131.9 million from December 31, 2020. Advances on our commercial FHA warehouse lines of credit decreased \$181.4 million to \$91.9 million at December 31, 2021. Excluding the decreases in PPP loans and commercial FHA warehouse lines, commercial loans increased \$77.9 million, primarily from our equipment financing business.

Consumer loans increased \$136.5 million primarily as a result of our relationship with GreenSky. On September 15, 2021, The Goldman Sachs Group, Inc. and GreenSky, Inc. announced that they had entered into a definitive agreement pursuant to which Goldman Sachs will acquire GreenSky. Based on recent discussions with GreenSky, we expect to remain in the GreenSky program at least through 2023. During this time, we will continue to originate loans through the GreenSky program with the plan to replace the level of payoffs that we experience and keep the portfolio relatively stable. After the new loan originations end, we expect that approximately 50% of the portfolio would run off over the first 12 months with the remainder paying off over several years.

The principal categories of our loan portfolio are discussed below:

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

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

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

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

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

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

The following table shows the contractual maturities of our loan portfolio and the distribution between fixed and adjustable interest rate loans at December 31, 2021:

| (dollars in thousands) | December 31, 2021 | | | | | | | | |
|-----------------------------------|-------------------|-------------------|------------------------|-------------------|-----------------------|-------------------|-------------------|-------------------|---------------------|
| | Within One Year | | One Year to Five Years | | Five Year to 15 Years | | After 15 Years | | Total |
| | Fixed Rates | Adjustable Rates | Fixed Rates | Adjustable Rates | Fixed Rates | Adjustable Rates | Fixed Rates | Adjustable Rates | |
| Loans: | | | | | | | | | |
| Commercial | \$ 58,716 | \$ 391,580 | \$ 673,656 | \$ 128,114 | \$ 146,061 | \$ 40,589 | \$ 3,049 | \$ 8,423 | \$ 1,450,188 |
| Commercial real estate | 268,282 | 132,972 | 674,699 | 375,908 | 148,114 | 156,521 | 17,996 | 42,336 | 1,816,828 |
| Construction and land development | 15,189 | 50,440 | 44,786 | 60,108 | 9,241 | 8,427 | 130 | 5,428 | 193,749 |
| Total commercial loans | 342,187 | 574,992 | 1,393,141 | 564,130 | 303,416 | 205,537 | 21,175 | 56,187 | 3,460,765 |
| Residential real estate | 2,307 | 7,510 | 13,618 | 23,885 | 28,044 | 30,897 | 126,551 | 105,339 | 338,151 |
| Consumer | 5,931 | 1,880 | 987,951 | 5,981 | 854 | — | 8 | — | 1,002,605 |
| Lease financing | 10,069 | — | 377,241 | — | 35,970 | — | — | — | 423,280 |
| Total loans | \$ 360,494 | \$ 584,382 | \$ 2,771,951 | \$ 593,996 | \$ 368,284 | \$ 236,434 | \$ 147,734 | \$ 161,526 | \$ 5,224,801 |

Loan Quality

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

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Analysis of the Allowance for Credit Losses on Loans. The following table allocates the allowance for credit losses on loans, or the allowance, by loan category:

| (dollars in thousands) | As of December 31, | | | | | |
|---------------------------------------------------|--------------------|------------------|------------------|------------------|--------------------------|------------------|
| | 2021 | | 2020 | | 2019 | |
| | Allowance | % ⁽²⁾ | Allowance | % ⁽²⁾ | Allowance ⁽¹⁾ | % ⁽²⁾ |
| Loans: | | | | | | |
| Commercial | \$ 14,375 | 0.99 % | \$ 19,851 | 1.18 % | \$ 10,031 | 0.95 % |
| Commercial real estate | 22,993 | 1.27 | 25,465 | 1.67 | 10,272 | 0.67 |
| Construction and land development | 972 | 0.50 | 1,433 | 0.83 | 290 | 0.14 |
| Total commercial loans | 38,340 | 1.11 | 46,749 | 1.38 | 20,593 | 0.74 |
| Residential real estate | 2,695 | 0.80 | 3,929 | 0.89 | 2,499 | 0.44 |
| Consumer | 2,558 | 0.26 | 2,338 | 0.27 | 2,642 | 0.37 |
| Lease financing | 7,469 | 1.76 | 7,427 | 1.81 | 2,294 | 0.69 |
| Total allowance for credit losses on loans | \$ 51,062 | 0.98 | \$ 60,443 | 1.18 | \$ 28,028 | 0.64 |

(1) Information presented prior to December 31, 2020 was modeled under the incurred loss model.

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

We measure expected credit losses over the life of each loan utilizing a combination of models which measure probability of default and loss given default, among other things. The measurement of expected credit losses is impacted by loan and borrower attributes and certain macroeconomic variables. Models are adjusted to reflect the impact of certain current macroeconomic variables as well as their expected changes over a reasonable and supportable forecast period.

The allowance allocated to commercial loans totaled \$14.4 million, or 0.99% of total commercial loans, at December 31, 2021, decreasing \$5.5 million from \$19.9 million at December 31, 2020. Modeled expected credit losses decreased \$7.6 million and qualitative factor ("Q-Factor") adjustments related to commercial loans increased \$0.4 million. Specific allocations for commercial loans that were evaluated for expected credit losses on an individual basis increased from \$1.2 million at December 31, 2020 to \$2.9 million at December 31, 2021.

The allowance allocated to commercial real estate loans totaled \$23.0 million, or 1.27% of total commercial real estate loans, at December 31, 2021, decreasing \$1.5 million, from \$25.5 million, or 1.67% of total commercial real estate loans, at December 31, 2020. Modeled expected credit losses related to commercial real estate loans decreased \$7.9 million and Q-Factor adjustments related to commercial real estate loans increased \$6.6 million. Specific allocations for commercial real estate loans that were evaluated for expected credit losses on an individual basis decreased from \$1.4 million at December 31, 2020 to \$0.1 million at December 31, 2021.

As previously stated, the overall loan portfolio increased \$121.5 million, or 2.4%, which included a \$290.9 million, or 19.1%, increase in commercial real estate loans, a \$21.0 million, or 12.2%, increase in construction and land development loans and a \$77.9 million, or 6.3%, increase in commercial loans, excluding PPP loans and commercial FHA warehouse lines. The weighted average risk grade for commercial loans of 4.53 at December 31, 2021, improved from 4.68 at December 31, 2020. Commercial loans graded "special mention" (risk grade 7) decreased \$16.2 million while classified commercial loans (risk grade of 8 or 9) decreased \$4.5 million. The weighted-average risk grade for commercial real estate loans improved to 5.02 at December 31, 2021 from 5.42 at December 31, 2020.

In estimating expected credit losses as of December 31, 2021, we utilized certain forecasted macroeconomic variables from Oxford Economics in our models. The forecasted projections included, among other things, (i) year over year change in U.S. gross domestic product ranging from 4.5% to 5.0% over the next three quarters; (ii) U.S. unemployment rate improving to 3.7% by the fourth quarter of 2022 with Illinois unemployment rates slightly higher at 4.0%; and (iii) an average 10 year Treasury rate forecasted at 2.30% in the fourth quarter of 2022. These economic metrics forecast an improving economy in 2022.

We qualitatively adjust the model results based on this scenario for various risk factors that are not considered within our modeling processes but are nonetheless relevant in assessing the expected credit losses within our loan pools. Q-Factor adjustments are based upon management judgment and current assessment as to the impact of risks related to changes in lending policies and procedures; economic and business conditions; loan portfolio attributes and credit concentrations; and external factors, among other things, that are not already captured within the modeling inputs, assumptions and other processes. Management assesses the potential impact of such items within a range of severely negative impact to positive impact and

adjusts the modeled expected credit loss by an aggregate adjustment percentage based upon the assessment. As a result of this assessment as of December 31, 2021, modeled expected credit losses were adjusted upwards with a Q-Factor adjustment of approximately 43 basis points of total loans, increasing slightly from 30 basis points at December 31, 2020. The Q-Factor adjustment at December 31, 2021 was based on an expected positive impact associated with changes in loan review system and oversight, and a negative impact from other risk factors associated with our commercial real estate portfolio, particularly the risks related to complex and higher loan balance relationships, and, to a certain level, change in the volume and severity of delinquent commercial real estate loans.

Management also made certain other qualitative adjustments for loans within certain industries that are expected to be more significantly impacted by the COVID pandemic. As of December 31, 2020, we provided an additional qualitative adjustment of \$2.3 million for our hotel and motel and our transit and ground transportation loan portfolios based on continued customer requests for loan modifications. This qualitative adjustment was fully reversed in 2021 due to improvements within the portfolios.

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

| (dollars in thousands) | As of and for the Year Ended December 31, | | |
|----------------------------------------|-------------------------------------------|--------------|--------------|
| | 2021 | 2020 | 2019 |
| Balance, beginning of period | \$ 60,443 | \$ 28,028 | \$ 20,903 |
| Impact of adopting ASC 326 | — | 8,546 | — |
| Impact of adopting ASC 326 - PCD loans | — | 4,237 | — |
| Charge-offs: | | | |
| Commercial | 6,465 | 5,589 | 3,412 |
| Commercial real estate | 3,524 | 13,637 | 3,339 |
| Construction and land development | 448 | 376 | 44 |
| Residential real estate | 398 | 522 | 1,076 |
| Consumer | 1,158 | 1,624 | 1,946 |
| Lease financing | 3,427 | 3,706 | 2,251 |
| Total charge-offs | 15,420 | 25,454 | 12,068 |
| Recoveries: | | | |
| Commercial | 341 | 147 | 67 |
| Commercial real estate | 21 | 324 | 949 |
| Construction and land development | 221 | 107 | 15 |
| Residential real estate | 249 | 184 | 142 |
| Consumer | 514 | 645 | 667 |
| Lease financing | 743 | 530 | 368 |
| Total recoveries | 2,089 | 1,937 | 2,208 |
| Net charge-offs | 13,331 | 23,517 | 9,860 |
| Provision for credit losses on loans | 3,950 | 43,149 | 16,985 |
| Balance, end of period | \$ 51,062 | \$ 60,443 | \$ 28,028 |
| Gross loans, end of period | \$ 5,224,801 | \$ 5,103,331 | \$ 4,401,410 |
| Average total loans | \$ 4,903,447 | \$ 4,721,823 | \$ 4,232,810 |
| Net charge-offs to average loans | 0.27 % | 0.50 % | 0.23 % |
| Allowance to total loans | 0.98 % | 1.18 % | 0.64 % |

Individual loans considered to be uncollectible are charged off against the allowance. Factors used in determining the amount and timing of charge-offs on loans include consideration of the loan type, length of delinquency, sufficiency of collateral value, lien priority and the overall financial condition of the borrower. Collateral value is determined using updated appraisals or other market comparable information. Recoveries on loans previously charged off are added to the allowance.

Net charge-offs for 2021 totaled \$13.3 million, compared to \$23.5 million for 2020. Approximately \$10.2 million of the net charge-offs in 2020 were related to three loans that had been on non-performing status with specific reserves held

against them for at least one year. These charge-offs were unrelated to the impact of the COVID pandemic. Net charge-offs to average loans were 0.27% and 0.50% for 2021 and 2020, respectively.

Nonperforming Loans. The following table sets forth our nonperforming assets by asset categories as of the dates indicated. Nonperforming loans include nonaccrual loans, loans past due 90 days or more and still accruing interest and loans modified under troubled debt restructurings. Deferrals related to COVID are not included as TDRs as of December 31, 2021 and 2020. The balances of nonperforming loans reflect the net investment in these assets, including deductions for purchase discounts.

| (dollars in thousands) | As of December 31, | | |
|------------------------------------------------------|--------------------|-----------|-----------|
| | 2021 | 2020 | 2019 |
| Nonperforming loans: | | | |
| Commercial | \$ 12,261 | \$ 7,995 | \$ 6,278 |
| Commercial real estate | 19,175 | 27,269 | 23,462 |
| Construction and land development | 120 | 2,863 | 1,349 |
| Residential real estate | 7,912 | 13,030 | 9,024 |
| Consumer | 208 | 303 | 376 |
| Lease financing | 2,904 | 2,610 | 1,593 |
| Total nonperforming loans | 42,580 | 54,070 | 42,082 |
| Other real estate owned and other repossessed assets | 14,488 | 21,362 | 7,945 |
| Nonperforming assets | \$ 57,068 | \$ 75,432 | \$ 50,027 |
| Nonperforming loans to total loans | 0.81 % | 1.06 % | 0.96 % |
| Nonperforming assets to total assets | 0.77 % | 1.10 % | 0.82 % |
| Allowance for credit losses to nonperforming loans | 119.92 % | 111.79 % | 66.60 % |

We did not recognize interest income on nonaccrual loans during the years ended December 31, 2021 and 2020 while they were in nonaccrual status. Additional interest income that we would have recognized on these loans had they been current in accordance with their original terms was \$2.7 million and \$3.3 million during the years ended December 31, 2021 and 2020, respectively. We recognized interest income on commercial and commercial real estate loans modified under troubled debt restructurings of \$0.1 million during each of the years ended December 31, 2021 and 2020.

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

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

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

| (dollars in thousands) | Commercial | | Commercial Real Estate | | Construction & Land Development | | | Total | |
|------------------------|---------------|------------------|------------------------|------------------|---------------------------------|------------------|------------|-------|--|
| | Risk Category | | Risk Category | | Risk Category | | | | |
| | 7 | 8 ⁽¹⁾ | 7 | 8 ⁽¹⁾ | 7 | 8 ⁽¹⁾ | | | |
| December 31, 2021 | \$ 28,248 | \$ 20,413 | \$ 46,295 | \$ 108,634 | \$ 5,235 | \$ 1,336 | \$ 210,161 | | |
| December 31, 2020 | 43,890 | 29,708 | 83,424 | 166,769 | 454 | 11,176 | 335,421 | | |
| December 31, 2019 | 17,435 | 22,952 | 18,450 | 66,231 | 2,420 | 1,250 | 128,738 | | |

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

Commercial real estate loans with a risk rating of 7 or 8 decreased \$95.3 million to \$154.9 million as of December 31, 2021, compared to December 31, 2020, primarily due to risk rating upgrades of several hotel-related relationships totaling \$60.3 million.

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

The following table sets forth the book value and percentage of each category of investment securities at December 31, 2021, 2020 and 2019. The book value for investment securities classified as available for sale is equal to fair market value.

| (dollars in thousands) | December 31, | | | | | |
|---------------------------------------------------------------|-------------------|----------------|-------------------|----------------|-------------------|----------------|
| | 2021 | | 2020 | | 2019 | |
| | Book Value | % of Total | Book Value | % of Total | Book Value | % of Total |
| Investment securities available for sale: | | | | | | |
| U.S. Treasury securities | \$ 64,917 | 7.2 % | \$ — | — % | \$ — | — % |
| U.S government sponsored entities and U.S. agency securities | 33,817 | 3.7 | 35,567 | 5.2 | 60,020 | 9.2 |
| Mortgage-backed securities - agency | 440,270 | 48.5 | 344,577 | 50.9 | 324,974 | 50.0 |
| Mortgage-backed securities - non-agency | 28,706 | 3.2 | 20,744 | 3.1 | 17,148 | 2.7 |
| State and municipal securities | 143,099 | 15.8 | 129,765 | 19.2 | 124,555 | 19.2 |
| Corporate securities | 195,794 | 21.6 | 146,058 | 21.6 | 122,736 | 18.9 |
| Total investment securities available for sale, at fair value | <u>\$ 906,603</u> | <u>100.0 %</u> | <u>\$ 676,711</u> | <u>100.0 %</u> | <u>\$ 649,433</u> | <u>100.0 %</u> |

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The following table sets forth the book value, maturities and weighted average yields for our investment portfolio at December 31, 2021. The book value for investment securities classified as available for sale is equal to fair market value.

| (dollars in thousands) | December 31, 2021 | | |
|-----------------------------------------------------------------------|-------------------|------------|------------------------|
| | Book Value | % of Total | Weighted Average Yield |
| Investment securities available for sale: | | | |
| <i>U.S. Treasury securities</i> | | | |
| Maturing within one year | \$ 325 | 0.1 % | 0.1 % |
| Maturing in one to five years | 64,592 | 7.1 | 0.9 |
| Maturing in five to ten years | — | — | — |
| Maturing after ten years | — | — | — |
| Total U.S. Treasury securities | <u>\$ 64,917</u> | 7.2 % | 0.9 % |
| <i>U.S. government sponsored entities and U.S. agency securities:</i> | | | |
| Maturing within one year | \$ 1,011 | 0.1 % | 2.3 % |
| Maturing in one to five years | 8,343 | 0.9 | 1.1 |
| Maturing in five to ten years | 24,463 | 2.7 | 1.3 |
| Maturing after ten years | — | — | — |
| Total U.S. government sponsored entities and U.S. agency securities | <u>\$ 33,817</u> | 3.7 % | 1.3 % |
| <i>Mortgage-backed securities - agency:</i> | | | |
| Maturing within one year | \$ 11,218 | 1.2 % | 2.8 % |
| Maturing in one to five years | 195,703 | 21.6 | 1.8 |
| Maturing in five to ten years | 186,708 | 20.6 | 1.6 |
| Maturing after ten years | 46,641 | 5.1 | 2.0 |
| Total mortgage-backed securities - agency | <u>\$ 440,270</u> | 48.5 % | 1.8 % |
| <i>Mortgage-backed securities - non-agency:</i> | | | |
| Maturing within one year | \$ 4,188 | 0.5 % | 2.9 % |
| Maturing in one to five years | 24,095 | 2.7 | 1.5 |
| Maturing in five to ten years | 423 | — | 3.5 |
| Maturing after ten years | — | — | — |
| Total mortgage-backed securities - non-agency | <u>\$ 28,706</u> | 3.2 % | 1.7 % |
| <i>State and municipal securities⁽¹⁾:</i> | | | |
| Maturing within one year | \$ 4,080 | 0.5 % | 3.7 % |
| Maturing in one to five years | 49,816 | 5.5 | 4.0 |
| Maturing in five to ten years | 49,205 | 5.4 | 3.0 |
| Maturing after ten years | 39,998 | 4.4 | 2.7 |
| Total state and municipal securities | <u>\$ 143,099</u> | 15.8 % | 3.3 % |
| <i>Corporate securities:</i> | | | |
| Maturing within one year | \$ 4,560 | 0.5 % | 3.5 % |
| Maturing in one to five years | 16,705 | 1.8 | 2.2 |
| Maturing in five to ten years | 174,529 | 19.3 | 3.6 |
| Maturing after ten years | — | — | — |
| Total corporate securities | <u>\$ 195,794</u> | 21.6 % | 3.5 % |
| Total investment securities available for sale | <u>\$ 906,603</u> | 100.0 % | 2.3 % |

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

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The table below presents the credit ratings for our investment securities classified as available for sale, at fair value, at December 31, 2021:

| (dollars in thousands) | Amortized Cost | Estimated Fair Value | December 31, 2021 | | | | | | |
|---------------------------------------------------------------|-------------------|----------------------|-----------------------|-------------------|------------------|-------------------|-------------|-------------|------------------|
| | | | Average Credit Rating | | | | | | |
| | | | AAA | AA+/- | A+/- | BBB+/- | <BBB- | Not Rated | |
| Investment securities available for sale: | | | | | | | | | |
| U.S. Treasury securities | \$ 65,347 | \$ 64,917 | \$ 64,917 | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |
| U.S. government sponsored entities and U.S. agency securities | 34,569 | 33,817 | 27,930 | 5,887 | — | — | — | — | — |
| Mortgage-backed securities - agency | 444,484 | 440,270 | 2,448 | 437,822 | — | — | — | — | — |
| Mortgage-backed securities - non-agency | 29,037 | 28,706 | 28,706 | — | — | — | — | — | — |
| State and municipal securities | 137,904 | 143,099 | 16,040 | 112,737 | 5,012 | 1,013 | — | — | 8,297 |
| Corporate securities | 193,354 | 195,794 | — | — | 65,579 | 126,404 | — | — | 3,811 |
| Total investment securities available for sale | <u>\$ 904,695</u> | <u>\$ 906,603</u> | <u>\$ 140,041</u> | <u>\$ 556,446</u> | <u>\$ 70,591</u> | <u>\$ 127,417</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 12,108</u> |

Cash and Cash Equivalents. Cash and cash equivalents increased \$338.7 million to \$680.4 million at December 31, 2021 compared to December 31, 2020. In October 2021, \$468.9 million in low-cost servicing deposits were received from Dwight Capital, increasing cash balances. Also in October 2021, the Company used a portion of its excess liquidity to repay \$130.0 million of FHLB advances. The Company continues to evaluate prudent alternatives to manage its liquidity.

Loans Held for Sale. Loans held for sale totaled \$32.0 million at December 31, 2021, comprised of \$19.2 million of commercial real estate loans and \$12.8 million of residential real estate loans, compared to \$138.1 million at December 31, 2020, comprised of \$126.1 million of commercial real estate loans and \$12.0 million of residential real estate loans. The commercial real estate loans represented modified loans, originated by Love Funding, that were sold into the secondary market.

Liabilities. Total liabilities increased to \$6.78 billion at December 31, 2021 compared to \$6.25 billion at December 31, 2020.

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

Total deposits increased \$1.01 billion to \$6.11 billion at December 31, 2021, as compared to December 31, 2020. Noninterest-bearing demand accounts increased \$776.1 million to \$2.25 billion at December 31, 2021 compared to December 31, 2020. Servicing deposits accounted for \$663.5 million of this increase, primarily due to \$468.9 million in servicing deposits received from Dwight Capital in October 2021, in accordance with the commercial FHA origination platform sales agreement. Interest-bearing transaction accounts increased \$258.5 million to \$3.21 billion at December 31, 2021 and time deposits decreased \$25.0 million to \$653.7 million.

Commercial deposits accounted for \$226.4 million of the increase in total deposits due, primarily to funds from PPP loan advances. Retail deposits increased \$83.3 million due in large part to customers' receipt of payments from the American Rescue Plan Act of 2021 stimulus package. At December 31, 2021, the composition of total deposits was 36.8% of noninterest-bearing demand accounts, 52.5% of interest-bearing transaction accounts and 10.7% of time deposits. At December 31, 2020, total deposits were comprised 28.8% of noninterest-bearing demand accounts, 57.9% of interest-bearing transaction accounts and 13.3% of time deposits. This change in mix was due to the increase in servicing deposits and our customers' preference to maintain liquidity, resulting in decreased time deposits, in this current low rate environment.

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The following table summarizes our average deposit balances and weighted average rates for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | December 31, | | | | | |
|----------------------------|-----------------|-----------------------|-----------------|-----------------------|-----------------|-----------------------|
| | 2021 | | 2020 | | 2019 | |
| | Average Balance | Weighted Average Rate | Average Balance | Weighted Average Rate | Average Balance | Weighted Average Rate |
| <i>Deposits</i> | | | | | | |
| Noninterest-bearing demand | \$ 1,568,005 | — | \$ 1,255,031 | — | \$ 959,363 | — |
| Interest-bearing: | | | | | | |
| Checking | 1,645,880 | 0.14 % | 1,499,199 | 0.27 % | 1,112,879 | 0.59 % |
| Money market | 821,408 | 0.09 | 831,458 | 0.46 | 775,475 | 1.00 |
| Savings | 655,735 | 0.02 | 567,398 | 0.04 | 489,270 | 0.18 |
| Time, insured | 551,748 | 1.12 | 611,570 | 1.78 | 664,850 | 1.97 |
| Time, uninsured | 138,810 | 0.88 | 100,774 | 1.88 | 102,733 | 2.32 |
| Time, brokered | 32,419 | 1.23 | 24,387 | 2.52 | 136,503 | 2.52 |
| Total interest-bearing | 3,846,000 | 0.28 | 3,634,786 | 0.59 | 3,281,710 | 1.04 |
| Total deposits | \$ 5,414,005 | 0.20 % | \$ 4,889,817 | 0.44 % | \$ 4,241,073 | 0.81 % |

The following table sets forth the maturity of uninsured time deposits as of December 31, 2021:

| (dollars in thousands) | Amount |
|------------------------|------------|
| Three months or less | \$ 20,421 |
| Three to six months | 21,464 |
| Six to 12 months | 46,283 |
| After 12 months | 55,319 |
| Total | \$ 143,487 |

Short-Term Borrowings. In addition to deposits, we use short-term borrowings, such as federal funds purchased and securities sold under agreements to repurchase, as a source of funds to meet the daily liquidity needs of our customers and fund growth in earning assets. Short-term borrowings were \$76.8 million at December 31, 2021 compared to \$69.0 million at December 31, 2020. The weighted average interest rate on our short-term borrowings was 0.13% and 0.12% at December 31, 2021 and 2020, respectively.

FHLB Advances and Other Borrowings. FHLB advances and other borrowings totaled \$310.2 million and \$779.2 million as of December 31, 2021 and 2020, respectively. As mentioned previously, in 2021, the Company pre-paid FHLB advances of \$50.0 million in the first quarter, \$85.0 million in the second quarter and \$130.0 million in the fourth quarter. None of these advances were replaced due to the Company's excess liquidity. The weighted average cost of the FHLB borrowings was 1.54% at December 31, 2021.

Subordinated Debt. Subordinated debt totaled \$139.1 million and \$169.8 million as of December 31, 2021 and 2020, respectively. On June 18, 2021, the Company redeemed all of its outstanding fixed-to-floating rate subordinated notes due June 18, 2025, having an aggregate principal amount of \$31.1 million, in accordance with the terms of the notes. The interest rate on the redeemed subordinated notes was 4.54%.

Capital Resources and Liquidity Management

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

Shareholders' equity increased \$42.4 million to \$663.8 million at December 31, 2021 as compared to December 31, 2020. The Company generated net income of \$81.3 million during 2021. Offsetting this increase to shareholders' equity were dividends to common shareholders of \$25.2 million and common stock repurchases of \$11.7 million.

On August 6, 2019, the Company announced that its Board of Directors authorized the Company to repurchase up to \$25.0 million of its common stock, which was increased to \$50.0 million on March 11, 2020 by an amendment approved by the Board of Directors. On December 2, 2020, the Company announced that the Board had extended the term of the repurchase program from December 31, 2020 to December 31, 2021. At the time of the extension, the program had approximately \$6.4 million of remaining repurchase authority. On September 7, 2021, the Company announced that the Board approved modifications to the Company's stock repurchase program, which increased the aggregate repurchase authority to \$75.0 million from \$50.0 million, and extended the expiration date of the program to December 31, 2022. At the time of the extension, the program had approximately \$1.3 million of remaining repurchase authority.

Stock repurchases under the program may be made from time to time on the open market, in privately negotiated transactions, or in any manner that complies with applicable securities laws, at the discretion of the Company. The timing of purchases and the number of shares repurchased under the program are dependent upon a variety of factors including price, trading volume, corporate and regulatory requirements and market condition. The repurchase program may be suspended or discontinued at any time without notice. As of December 31, 2021, \$55.3 million, or 2,953,768 shares of the Company's common stock, had been repurchased under the program, with approximately \$19.7 million of remaining repurchase authority.

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

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

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction, which represents the amount of the Bank's obligation. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. Investment securities with a carrying amount of \$78.3 million and \$76.5 million at December 31, 2021 and December 31, 2020, respectively, were pledged for securities sold under agreements to repurchase.

The Company had available lines of credit of \$55.9 million and \$54.4 million at December 31, 2021 and December 31, 2020, respectively, from the Federal Reserve Discount Window. The lines are collateralized by a collateral agreement with respect to a pool of commercial real estate loans totaling \$64.8 million and \$68.1 million at December 31, 2021 and 2020, respectively. There were no outstanding borrowings at December 31, 2021 and 2020.

At December 31, 2021, the Company had available federal funds lines of credit totaling \$45.0 million, which were unused.

At December 31, 2021 and 2020, we had capacity to borrow \$863.7 million and \$334.0 million, respectively, from the FHLB. The Company's advances from the FHLB are collateralized by a blanket collateral agreement of qualifying mortgage and home equity line of credit loans and certain commercial real estate loans totaling \$2.10 billion and \$1.86 billion at December 31, 2021 and 2020, respectively.

The Company is a corporation separate and apart from the Bank and, therefore, must provide for its own liquidity. The Company's main source of funding is dividends declared and paid to us by the Bank. There are statutory, regulatory and debt covenant limitations that affect the ability of the Bank to pay dividends to the Company. Management believed at December 31, 2021, that these limitations will not impact our ability to meet our ongoing short-term cash obligations.

Regulatory Capital Requirements

We are subject to various regulatory capital requirements administered by the federal and state banking regulators. Failure to meet regulatory capital requirements may result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for "prompt corrective action", we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting policies.

In December 2018, the Office of the Comptroller of the Currency, the Federal Reserve, and the FDIC approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard. In March 2020, the Office of the Comptroller of the Currency, the Federal Reserve, and the FDIC published an interim final rule to delay the estimated impact on regulatory capital stemming from the implementation of CECL. The interim final rule maintains the three-year transition option in the previous rule and provides banks the option to delay for two years an estimate of CECL's effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period (five-year transition option). The Company is adopting the capital transition relief over the permissible five-year period.

At December 31, 2021, the Company and the Bank exceeded the regulatory minimums and met the regulatory definition of well-capitalized.

The following table presents the Company and the Bank's capital ratios and the minimum requirements at December 31, 2021:

| Ratio | Actual | Minimum Regulatory Requirements ⁽¹⁾ | Well Capitalized |
|---------------------------------------------------------|---------|------------------------------------------------|------------------|
| Total capital (to risk-weighted assets): | | | |
| Midland States Bancorp, Inc. | 12.19 % | 10.50 % | N/A |
| Midland States Bank | 11.21 | 10.50 | 10.00 % |
| Tier 1 capital (to risk-weighted assets): | | | |
| Midland States Bancorp, Inc. | 9.16 | 8.50 | N/A |
| Midland States Bank | 10.49 | 8.50 | 8.00 |
| Common equity tier 1 capital (to risk-weighted assets): | | | |
| Midland States Bancorp, Inc. | 8.08 | 7.00 | N/A |
| Midland States Bank | 10.49 | 7.00 | 6.50 |
| Tier 1 leverage (to average assets): | | | |
| Midland States Bancorp, Inc. | 7.75 | 4.00 | N/A |
| Midland States Bank | 8.89 | 4.00 | 5.00 |

(1) Total risk-based capital ratio, Common equity tier 1 risk-based capital ratio and Tier 1 risk-based capital ratio include the capital conservation buffer of 2.5%.

Off-Balance Sheet Arrangements

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

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

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

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

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

Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Risk

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

We actively manage interest rate risk, as changes in market interest rates may have a significant impact on reported earnings. Changes in market interest rates may result in changes in the fair market value of our financial instruments, cash flows, and net interest income. We seek to achieve consistent growth in net interest income and capital while managing volatility arising from shifts in market interest rates. Our Board of Directors' Risk Policy and Compliance Committee oversees interest rate, as well as the establishment of risk measures, limits, and policy guidelines for managing the amount of interest rate and mortgage price risk and its effect on net interest income and capital. Responsibility for measuring and the management of interest rate risk resides with Corporate Treasury. Our Risk Policy and Compliance Committee meets quarterly to monitor the level of interest rate risk sensitivity to ensure compliance with the board of directors' approved risk limits.

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

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

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

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

NII at risk uses net interest income simulation analysis which involves forecasting net interest earnings under a variety of scenarios including changes in the level of interest rates, the shape of the yield curve, and spreads between market interest rates. The sensitivity of net interest income to changes in interest rates is measured using numerous interest rate scenarios including shocks, gradual ramps, curve flattening, curve steepening as well as forecasts of likely interest rates scenarios. Modeling the sensitivity of net interest earnings to changes in market interest rates is highly dependent on numerous assumptions incorporated into the modeling process. To the extent that actual performance is different than what was assumed, actual net interest earnings sensitivity may be different than projected. We use a data warehouse to study interest rate risk at a transactional level and uses various ad-hoc reports to continuously refine assumptions. Assumptions and methodologies

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regarding administered rate liabilities (e.g., savings accounts, money market accounts and interest-bearing checking accounts), balance trends, and repricing relationships reflect our best estimate of expected behavior and these assumptions are reviewed periodically.

We also have longer-term interest rate risk exposure, which may not be appropriately measured by earnings sensitivity analysis. The Risk Policy and Compliance Committee uses EVE to study the impact of long-term cash flows on earnings and on capital. EVE involves discounting present values of all cash flows of on and off-balance sheet items under different interest rate scenarios. The discounted present value of all cash flows represents our EVE. The analysis requires modifying the expected cash flows in each interest rate scenario, which will impact the discounted present value. The amount of base-case measurement and its sensitivity to shifts in the yield curve allow us to measure longer-term repricing and option risk in the balance sheet.

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

| (dollars in thousands) | Net Interest Income Sensitivity (Shocks) | | |
|------------------------|------------------------------------------|-----------|-----------|
| | Immediate Change in Rates | | |
| | -100 | +100 | +200 |
| December 31, 2021: | | | |
| Dollar change | \$ (13,499) | \$ 23,513 | \$ 47,028 |
| Percent change | (6.1)% | 10.6 % | 21.2 % |
| December 31, 2020: | | | |
| Dollar change | \$ (6,585) | \$ 5,790 | \$ 10,376 |
| Percent change | (3.1)% | 2.7 % | 4.9 % |
| December 31, 2019: | | | |
| Dollar change | \$ (10,540) | \$ 2,404 | \$ 1,750 |
| Percent change | (5.4)% | 1.2 % | 0.9 % |

We report NII at Risk to isolate the change in income related solely to interest-earning assets and interest-bearing liabilities. The NII at Risk results included in the table above reflect the analysis used quarterly by management. It models -100, +100 and +200 basis point parallel shifts in market interest rates, implied by the forward yield curve over the next twelve months. We were within board policy limits for the +100 and +200 basis point scenarios at December 31, 2021 and out of compliance for the -100 basis point scenario. The Company is continuing to monitor its compliance with this policy limit.

Tolerance levels for risk management require the continuing development of remediation plans to maintain residual risk within approved levels as we adjust the balance sheet. NII at Risk reported at December 31, 2021, projected that our earnings exhibited increased sensitivity to changes in interest rates in all scenarios compared to December 31, 2020.

The following table shows EVE at the dates indicated:

| (dollars in thousands) | Economic Value of Equity Sensitivity (Shocks) | | |
|------------------------|-----------------------------------------------|-----------|------------|
| | Immediate Change in Rates | | |
| | -100 | +100 | +200 |
| December 31, 2021: | | | |
| Dollar change | \$ (89,850) | \$ 51,553 | \$ 96,875 |
| Percent change | (13.4)% | 7.7 % | 14.5 % |
| December 31, 2020: | | | |
| Dollar change | \$ (90,487) | \$ 74,568 | \$ 131,224 |
| Percent change | (13.9)% | 11.5 % | 20.2 % |
| December 31, 2019: | | | |
| Dollar change | \$ (91,101) | \$ 49,546 | \$ 73,267 |
| Percent change | (16.3)% | 8.9 % | 13.1 % |

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

The EVE reported at December 31, 2021 projected that as interest rates increase, the economic value of equity position will increase, and as interest rates decrease, the economic value of equity position will decrease. When interest rates rise, fixed rate assets generally lose economic value; the longer the duration, the greater the value lost. The opposite is true when interest rates fall.

We were within board policy limits for the +100 and +200 basis point scenarios at December 31, 2021 and out of compliance for the -100 basis point scenario. The Company is continuing to monitor its compliance with this policy limit.

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

Critical Accounting Estimates

Our most significant accounting policies are described in Note 1 to the consolidated financial statements. Certain of these accounting policies require management to use significant judgment and estimates, which can have a material impact on the carrying value of certain assets and liabilities, and we consider these policies to be our critical accounting estimates. The judgment and assumptions made are based upon historical experience, future forecasts, or other factors that management believes to be reasonable under the circumstances. Because of the nature of the judgment and assumptions, actual results could differ from estimates, which could have a material effect on our financial condition and results of operations.

The following accounting policies materially affect our reported earnings and financial condition and require significant judgments and estimates. Management has reviewed these critical accounting estimates and related disclosures with our Audit Committee.

Allowance for Credit Losses on Loans. Management's evaluation process used to determine the appropriateness of the allowance for credit losses on loans is subject to the use of estimates, assumptions, and judgments. The evaluation process combines many factors: management's ongoing review and grading of the loan portfolio leveraging probability of default and loss given default, consideration of historical loan loss and delinquency experience, trends in past due and nonaccrual loans, risk characteristics of the various classifications of loans, concentrations of loans to specific borrowers or industries, existing economic conditions and forecasts, the fair value of underlying collateral, and other qualitative and quantitative factors which could affect future credit losses. Because current economic conditions and forecasts can change and future events are inherently difficult to predict, the anticipated amount of estimated credit losses on loans, and therefore the appropriateness of the allowance for credit losses on loans, could change significantly. It is difficult to estimate how potential changes in any one economic factor or input might affect the overall allowance because a wide variety of factors and inputs are considered in estimating the allowance and changes in those factors and inputs considered may not occur at the same rate and may not be consistent across all product types. Additionally, changes in factors and inputs may be directionally inconsistent, such that improvement in one factor may offset deterioration in others. As an integral part of their examination process, various regulatory agencies also review the allowance for credit losses on loans. Such agencies may require additions to the allowance for credit losses on loans or may require that certain loan balances be charged off or downgraded into criticized loan categories when their credit evaluations differ from those of management, based on their judgments about information available to them at the time of their examination. The Company believes the level of the allowance for credit losses on loans is appropriate. See Note 1 - *Summary of Significant Accounting Policies* and Note 5 - *Loans* of the notes to consolidated financial statements.

Commercial FHA Servicing Rights Valuation. The fair value of the Company's commercial FHA servicing asset is important to the presentation of the consolidated financial statements since the servicing asset is carried on the consolidated balance sheets at the lower of amortized cost or estimated fair value. Commercial FHA servicing rights do not trade in an active open market with readily observable prices. As such, like other participants in the mortgage banking business, the Company relies on an independent valuation from a third party which uses a discounted cash flow model to estimate the fair value of its commercial FHA servicing rights. The use of a discounted cash flow model involves judgment, particularly of estimated prepayment speeds of underlying mortgages serviced, the amount of escrow balances, including replacement reserves, and the overall level of interest rates. The Company periodically reviews the assumptions underlying the valuation of commercial FHA servicing rights. While the Company believes that the values produced by the discounted cash flow model are indicative of the fair value of its commercial FHA servicing rights portfolio, these values can change significantly depending upon key factors, such as the then current interest rate environment, estimated prepayment speeds of the underlying mortgages serviced, and other economic conditions. The proceeds that might be received should the Company consider a sale of the commercial FHA servicing rights portfolio could differ from the amounts reported at any point in time.

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The Company believes the commercial FHA servicing rights asset is properly recorded on the consolidated balance sheets. See Note 1 - *Summary of Significant Accounting Policies* and Note 8 – *Loan Servicing Rights* of the notes to consolidated financial statements.

ITEM 7A – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 8 – FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Midland States Bancorp, Inc. (the "Company") as of December 31, 2021 and 2020, the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2021, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2021, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2021 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2021, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Company changed its method for accounting for credit losses effective January 1, 2020, due to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification No. 326, Financial Instruments - Credit Losses (ASC 326). The Company adopted the new credit loss standard using the modified retrospective method such that prior period amounts are not adjusted and continue to be reported in accordance with previously applicable generally accepted accounting principles.

Basis for Opinions

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

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

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Allowance for Credit Losses on Loans

As described in Notes 1 and 5 to the consolidated financial statements, the Allowance for Credit Losses on Loans ("ACL") represents the Company's estimate of amounts that are not expected to be collected over the contractual life of the Company's held for investment loan portfolio. The estimate of the ACL is based on historical experience, current conditions, and reasonable and supportable forecasts. As of December 31, 2021, the Company's ACL was \$51,062,000, and the provision for credit losses on loans was \$3,950,000 for the year then ended.

The Company employed a probability of default ("PD") and loss given default ("LGD") modeling approach to estimate the ACL, which were then adjusted for qualitative factors. The estimated PD and LGD rates are applied to the estimated exposure at default ("EAD") to calculate expected credit losses. The Company's CECL model utilizes regression analysis to develop default rates based on forecasted macroeconomic variables that correlate to and are predictive of losses. The methodologies utilized to develop and implement the macroeconomic factors that drive the loss estimates in the forecasting model were complex in their use of regression modeling techniques. The process involved the selection of the macroeconomic variables and the evaluation of regression analysis outputs to determine the statistical fit of the macroeconomic variables used to forecast expected credit losses. The Company also developed a qualitative analysis framework to address asset specific risks, changes in economic and business conditions, the impact of COVID-19 on its customers' operations and/or other factors that were not inherently

considered by the model for each portfolio segment. Significant management judgment was required in evaluating the qualitative factor adjustments used in the analysis.

The audit procedures over the modeling techniques used to determine loss estimates and the selection and application of the macroeconomic variables involved a high degree of auditor judgment and required significant audit effort, including the use of more experienced audit personnel and use of our credit and valuation specialists due to its complexity. Additionally, the audit procedures over the qualitative factor adjustments utilized in management's methodology involved challenging and subjective auditor judgment. Therefore, we identified auditing the CECL modeling techniques and qualitative factor adjustments as a critical audit matter.

The primary audit procedures we performed to address this critical audit matter included:

- Tested the operating effectiveness of the Company's controls over:
 - The Company's allowance committee's oversight and approval of management's application of accounting policies, and selection and implementation of PD and LGD assumptions.
 - Management's review relating to selection and application of relevant macroeconomic variables and their appropriateness.
 - Management's review over the calculation methodologies, adjustments and validation of the allowance model.
 - The completeness and accuracy of internal data used in the loss estimation models and in the qualitative analysis framework.
 - Management's review over the relevance and reliability of external data used in the loss estimation model and qualitative analysis framework.
 - The mathematical accuracy of the qualitative factor adjustments.
- Evaluated the reasonableness and appropriateness of the methodologies employed for suitability under the standard including, but not limited to, evaluating their conceptual soundness and testing the PD models and LGD assumptions and judgments in estimating expected credit losses.
- Tested the internal data used in the loss estimation model for completeness and accuracy.
- Specific to the qualitative analysis we performed the following procedures, among others:
 - Assessed the appropriateness and reasonableness of the framework developed for the qualitative analysis including evaluating management's judgments as to which factors impacted the qualitative analysis for each portfolio segment.
 - Evaluated the relevance and reliability of external data used in the qualitative analysis methodology.
 - Performed testing over the accuracy of inputs utilized in the calculation of qualitative analysis for each portfolio segment.
 - Tested the mathematical accuracy of the calculation of the qualitative factor adjustments.

Commercial FHA Servicing Rights – Determining the Fair Value

As described in Notes 1 and 8 to the consolidated financial statements, as part of its commercial mortgage banking activities, the Company holds mortgage servicing rights (“MSR’s”) resulting from the right to service loans that are sold in the secondary market. These MSR’s are carried at the lower of the initial capitalized amount, net of accumulated amortization, or estimated fair value. As of December 31, 2021, the balance of the MSR’s was \$28,865,000.

Determining the fair value of the MSR is considered a critical accounting estimate, as it requires significant judgment and the use of subjective measurements. The fair value is estimated by using a cash flow valuation model that calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, escrow and replacement reserves, and other economic factors which are estimated based on current market conditions.

We identified the fair value determination of the commercial FHA mortgage servicing rights as a critical audit matter as the valuation methodology is complex and includes assumptions and estimates over unobservable inputs which require significant judgment to evaluate. Changes in these estimates and assumptions may have a material impact on the Company’s financial position or the results of operations. Auditing these elements involved challenging auditor judgment due to the nature and extent of audit effort required to address these matters, including the extent of specialized skill or knowledge needed.

The primary audit procedures we performed to address this critical audit matter included:

- Tested the operating effectiveness of the Company’s controls over:
 - The review of the completeness and accuracy of the internal loan data that is provided to the third-party valuation firm.
 - The review and approval by management of the valuation model, including the independent review of the significant assumptions and inputs used and the concluded placement within the calculated range.
- Used a third-party valuation specialist to assist in the evaluation of the reasonableness of fair value of the commercial FHA mortgage servicing rights.
- Tested the mathematical accuracy of the calculation.
- Tested the completeness and accuracy of the internal loan data used in the valuation model.

Crowe LLP

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

Indianapolis, Indiana
February 25, 2022

MIDLAND STATES BANCORP, INC.
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except per share data)

| | December 31, | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| | 2021 | 2020 |
| Assets | | |
| Cash and due from banks | \$ 673,297 | \$ 337,080 |
| Federal funds sold | 7,074 | 4,560 |
| Cash and cash equivalents | <u>680,371</u> | <u>341,640</u> |
| Investment securities available for sale, at fair value (allowance for credit losses of \$221 and \$366 at December 31, 2021 and 2020, respectively) | 906,603 | 676,711 |
| Equity securities, at fair value | 9,529 | 9,424 |
| Loans | 5,224,801 | 5,103,331 |
| Allowance for credit losses on loans | <u>(51,062)</u> | <u>(60,443)</u> |
| Total loans, net | 5,173,739 | 5,042,888 |
| Loans held for sale | 32,045 | 138,090 |
| Premises and equipment, net | 70,792 | 74,124 |
| Operating lease right-of-use assets | 8,428 | 9,177 |
| Other real estate owned | 12,059 | 20,247 |
| Nonmarketable equity securities | 36,341 | 56,596 |
| Accrued interest receivable | 19,470 | 23,545 |
| Loan servicing rights, at lower of cost or fair value | 28,865 | 40,154 |
| Goodwill | 161,904 | 161,904 |
| Other intangible assets, net | 24,374 | 28,382 |
| Cash surrender value of life insurance policies | 148,378 | 146,004 |
| Other assets | <u>130,907</u> | <u>99,654</u> |
| Total assets | <u>\$ 7,443,805</u> | <u>\$ 6,868,540</u> |
| Liabilities and Shareholders' Equity | | |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing | \$ 2,245,701 | \$ 1,469,579 |
| Interest-bearing | <u>3,864,947</u> | <u>3,631,437</u> |
| Total deposits | <u>6,110,648</u> | <u>5,101,016</u> |
| Short-term borrowings | 76,803 | 68,957 |
| FHLB advances and other borrowings | 310,171 | 779,171 |
| Subordinated debt | 139,091 | 169,795 |
| Trust preferred debentures | 49,374 | 48,814 |
| Operating lease liabilities | 10,714 | 11,958 |
| Other liabilities | <u>83,167</u> | <u>67,438</u> |
| Total liabilities | <u>6,779,968</u> | <u>6,247,149</u> |
| Shareholders' Equity: | | |
| Common stock, \$0.01 par value; 40,000,000 shares authorized; 22,050,537 and 22,325,471 shares issued and outstanding at December 31, 2021 and 2020, respectively | 221 | 223 |
| Capital surplus | 445,907 | 453,410 |
| Retained earnings | 212,472 | 156,327 |
| Accumulated other comprehensive income | <u>5,237</u> | <u>11,431</u> |
| Total shareholders' equity | <u>663,837</u> | <u>621,391</u> |
| Total liabilities and shareholders' equity | <u>\$ 7,443,805</u> | <u>\$ 6,868,540</u> |

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

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

| | Years Ended December 31, | | |
|-------------------------------------------------------|--------------------------|------------------|------------------|
| | 2021 | 2020 | 2019 |
| Interest income: | | | |
| Loans: | | | |
| Taxable | \$ 213,922 | \$ 217,459 | \$ 218,416 |
| Tax exempt | 2,470 | 3,110 | 3,593 |
| Loans held for sale | 1,115 | 1,881 | 1,375 |
| Investment securities: | | | |
| Taxable | 13,898 | 14,789 | 14,690 |
| Tax exempt | 3,336 | 3,532 | 4,098 |
| Nonmarketable equity securities | 2,348 | 2,638 | 2,395 |
| Federal funds sold and cash investments | 728 | 1,479 | 4,951 |
| Total interest income | <u>237,817</u> | <u>244,888</u> | <u>249,518</u> |
| Interest expense: | | | |
| Deposits | 10,957 | 21,498 | 34,194 |
| Short-term borrowings | 86 | 178 | 835 |
| FHLB advances and other borrowings | 8,443 | 12,033 | 13,935 |
| Subordinated debt | 8,705 | 9,730 | 7,404 |
| Trust preferred debentures | 1,951 | 2,313 | 3,335 |
| Total interest expense | <u>30,142</u> | <u>45,752</u> | <u>59,703</u> |
| Net interest income | <u>207,675</u> | <u>199,136</u> | <u>189,815</u> |
| Provision for credit losses: | | | |
| Provision for credit losses on loans | 3,950 | 43,149 | 16,985 |
| Provision for credit losses on unfunded commitments | (412) | 846 | — |
| Provision for other credit losses | (145) | 366 | — |
| Total provision for credit losses | <u>3,393</u> | <u>44,361</u> | <u>16,985</u> |
| Net interest income after provision for credit losses | <u>204,282</u> | <u>154,775</u> | <u>172,830</u> |
| Noninterest income: | | | |
| Wealth management revenue | 26,811 | 22,802 | 21,832 |
| Commercial FHA revenue | 1,414 | 6,007 | 15,309 |
| Residential mortgage banking revenue | 5,526 | 9,812 | 2,928 |
| Service charges on deposit accounts | 8,348 | 8,603 | 11,027 |
| Interchange revenue | 14,500 | 12,266 | 11,992 |
| Gain on sales of investment securities, net | 537 | 1,721 | 674 |
| Impairment on commercial mortgage servicing rights | (7,532) | (12,337) | (2,139) |
| Company-owned life insurance | 4,496 | 3,581 | 3,640 |
| Other income | 15,799 | 8,794 | 10,019 |
| Total noninterest income | <u>69,899</u> | <u>61,249</u> | <u>75,282</u> |
| Noninterest expense: | | | |
| Salaries and employee benefits | 86,883 | 85,557 | 91,906 |
| Occupancy and equipment | 14,866 | 17,552 | 18,811 |
| Data processing | 24,595 | 22,643 | 21,390 |
| Professional | 10,971 | 7,234 | 8,783 |
| Marketing | 3,239 | 3,498 | 3,927 |
| Communications | 3,002 | 4,052 | 3,693 |
| Amortization of intangible assets | 5,855 | 6,504 | 7,090 |
| Impairment related to facilities optimization | — | 12,847 | 3,577 |
| FHLB advances prepayment fees | 8,536 | 4,872 | — |
| Other expense | 17,122 | 19,251 | 16,464 |
| Total noninterest expense | <u>175,069</u> | <u>184,010</u> | <u>175,641</u> |
| Income before income taxes | <u>99,112</u> | <u>32,014</u> | <u>72,471</u> |
| Income taxes | <u>17,795</u> | <u>9,477</u> | <u>16,687</u> |
| Net income | <u>81,317</u> | <u>22,537</u> | <u>55,784</u> |
| Preferred stock dividends and premium amortization | — | — | 46 |
| Net income available to common shareholders | <u>\$ 81,317</u> | <u>\$ 22,537</u> | <u>\$ 55,738</u> |
| Per common share data: | | | |
| Basic earnings per common share | \$ 3.58 | \$ 0.95 | \$ 2.28 |
| Diluted earnings per common share | \$ 3.57 | \$ 0.95 | \$ 2.26 |
| Weighted average common shares outstanding | 22,481,389 | 23,336,881 | 24,288,793 |
| Weighted average diluted common shares outstanding | 22,547,353 | 23,346,126 | 24,493,431 |

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

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

| | Years Ended December 31, | | |
|-------------------------------------------------------------------------------------------------------------|--------------------------|------------------|------------------|
| | 2021 | 2020 | 2019 |
| Net income | \$ 81,317 | \$ 22,537 | \$ 55,784 |
| Other comprehensive income (loss): | | | |
| Investment securities available for sale: | | | |
| Unrealized gains (losses) that occurred during the period | (12,553) | 6,454 | 13,847 |
| Provision for (recapture of) credit loss expense | (145) | 366 | — |
| Reclassification adjustment for realized net gains on sales of investment securities included in net income | (537) | (1,721) | (674) |
| Income tax effect | 3,640 | (1,402) | (3,623) |
| Change in investment securities available for sale, net of tax | <u>(9,595)</u> | <u>3,697</u> | <u>9,550</u> |
| Cash flow hedges: | | | |
| Net unrealized derivative gains on cash flow hedges | 6,851 | 403 | — |
| Reclassification adjustment for realized net gains on cash flow hedges included in net income | (2,159) | — | — |
| Income tax effect | (1,291) | (111) | — |
| Change in cash flow hedges, net of tax | <u>3,401</u> | <u>292</u> | <u>—</u> |
| Other comprehensive income (loss), net of tax | <u>(6,194)</u> | <u>3,989</u> | <u>9,550</u> |
| Total comprehensive income | <u>\$ 75,123</u> | <u>\$ 26,526</u> | <u>\$ 65,334</u> |

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

MIDLAND STATES BANCORP, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2021, 2020 AND 2019
(dollars in thousands, except per share data)

| | Preferred stock | Common stock | Capital surplus | Retained earnings | Accumulated other comprehensive (loss) income | Total shareholders' equity |
|---------------------------------------------------------------|-----------------|---------------|-------------------|-------------------|-----------------------------------------------|----------------------------|
| Balance at December 31, 2018 | \$ 2,781 | \$ 238 | \$ 473,833 | \$ 133,781 | \$ (2,108) | \$ 608,525 |
| Net income | — | — | — | 55,784 | — | 55,784 |
| Other comprehensive income | — | — | — | — | 9,550 | 9,550 |
| Acquisition of HomeStar Financial Group, Inc. | — | 4 | 10,335 | — | — | 10,339 |
| Preferred dividends declared | — | — | — | (191) | — | (191) |
| Preferred stock, premium amortization | (145) | — | — | 145 | — | — |
| Redemption of Series H preferred stock | (2,636) | — | — | — | — | (2,636) |
| Common dividends declared (\$0.97 per share) | — | — | — | (23,599) | — | (23,599) |
| Common stock repurchased | — | (2) | (4,017) | — | — | (4,019) |
| Share-based compensation expense | — | — | 2,364 | — | — | 2,364 |
| Issuance of common stock under employee benefit plans | — | 4 | 5,790 | — | — | 5,794 |
| Balance at December 31, 2019 | \$ — | \$ 244 | \$ 488,305 | \$ 165,920 | \$ 7,442 | \$ 661,911 |
| Cumulative effect of change in accounting principles (Note 1) | — | — | — | (7,172) | — | (7,172) |
| Balance at January 1, 2020 | \$ — | \$ 244 | \$ 488,305 | \$ 158,748 | \$ 7,442 | \$ 654,739 |
| Net income | — | — | — | 22,537 | — | 22,537 |
| Other comprehensive income | — | — | — | — | 3,989 | 3,989 |
| Common dividends declared (\$1.07 per share) | — | — | — | (24,958) | — | (24,958) |
| Common stock repurchased | — | (23) | (39,592) | — | — | (39,615) |
| Share-based compensation expense | — | — | 2,175 | — | — | 2,175 |
| Issuance of common stock under employee benefit plans | — | 2 | 2,522 | — | — | 2,524 |
| Balance at December 31, 2020 | \$ — | \$ 223 | \$ 453,410 | \$ 156,327 | \$ 11,431 | \$ 621,391 |
| Net income | — | — | — | 81,317 | — | 81,317 |
| Other comprehensive loss | — | — | — | — | (6,194) | (6,194) |
| Common dividends declared (\$1.12 per share) | — | — | — | (25,172) | — | (25,172) |
| Common stock repurchased | — | (5) | (11,687) | — | — | (11,692) |
| Share-based compensation expense | — | — | 1,938 | — | — | 1,938 |
| Issuance of common stock under employee benefit plans | — | 3 | 2,246 | — | — | 2,249 |
| Balance at December 31, 2021 | \$ — | \$ 221 | \$ 445,907 | \$ 212,472 | \$ 5,237 | \$ 663,837 |

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

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MIDLAND STATES BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

| (dollars in thousands) | Years Ended December 31, | | |
|-----------------------------------------------------------------------------------|--------------------------|-------------|------------|
| | 2021 | 2020 | 2019 |
| Cash flows from operating activities: | | | |
| Net income | \$ 81,317 | \$ 22,537 | \$ 55,784 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for credit losses | 3,393 | 44,361 | 16,985 |
| Depreciation on premises and equipment | 5,506 | 6,942 | 6,583 |
| Amortization of intangible assets | 5,855 | 6,504 | 7,090 |
| Amortization of operating lease right-of-use asset | 1,742 | 2,547 | 2,937 |
| Amortization of loan servicing rights | 3,242 | 3,518 | 2,820 |
| Share-based compensation expense | 1,938 | 2,175 | 2,364 |
| Increase in cash surrender value of company-owned life insurance | (3,451) | (3,581) | (3,640) |
| Gain on proceeds from bank-owned life insurance | (1,045) | — | — |
| Investment securities amortization, net | 4,196 | 3,411 | 3,757 |
| Gain on sales of investment securities, net | (537) | (1,721) | (674) |
| Gain on termination of hedged interest rate swap | (2,159) | — | — |
| Gain on sales of other real estate owned | (473) | (78) | (185) |
| Impairment on other real estate owned | 454 | 1,390 | 16 |
| Origination of loans held for sale | (504,801) | (786,203) | (504,973) |
| Proceeds from sales of loans held for sale | 739,954 | 1,218,950 | 949,745 |
| Gain on loans sold and held for sale | (4,952) | (14,071) | (15,082) |
| Impairment on commercial mortgage servicing rights | 7,532 | 12,337 | 2,139 |
| Impairment related to facilities optimization | — | 12,847 | 3,577 |
| Net change in operating assets and liabilities: | | | |
| Accrued interest receivable | 4,075 | (7,199) | 1,399 |
| Other assets | (31,974) | (30,269) | (5,191) |
| Accrued expenses and other liabilities | 24,626 | 4,750 | 13,202 |
| Net cash provided by operating activities | 334,438 | 499,147 | 538,653 |
| Cash flows from investing activities: | | | |
| Purchases of investment securities available for sale | (469,789) | (266,514) | (200,231) |
| Proceeds from sales of investment securities available for sale | 14,777 | 28,256 | 33,464 |
| Maturities and payments on investment securities available for sale | 208,377 | 214,036 | 239,760 |
| Purchases of equity securities | (260) | (3,345) | (82) |
| Proceeds from sales of equity securities | — | — | 105 |
| Net increase in loans | (258,401) | (1,279,913) | (505,501) |
| Proceeds from sale of commercial FHA origination platform | — | 7,502 | — |
| Purchases of premises and equipment | (2,718) | (2,589) | (5,538) |
| Proceeds from sale of premises and equipment | 647 | — | — |
| Purchases of nonmarketable equity securities | — | (12,091) | (14,263) |
| Proceeds from sales of nonmarketable equity securities | 20,255 | — | 12,684 |
| Proceeds from sales of mortgage servicing rights held for sale | — | — | 3,288 |
| Proceeds from sales of other real estate owned | 9,210 | 2,225 | 1,647 |
| Purchases of company-owned life insurance | (550) | — | — |
| Proceeds from settlements of company-owned life insurance | 2,672 | — | — |
| Net cash (paid) acquired in acquisitions | (2,715) | — | 69,879 |
| Net cash used in investing activities | (478,495) | (1,312,433) | (364,788) |
| Cash flows from financing activities: | | | |
| Net increase in deposits | 1,009,632 | 556,762 | 148,344 |
| Net increase (decrease) in short-term borrowings | 7,846 | (13,072) | (42,206) |
| Proceeds from FHLB borrowings | 500,000 | 729,000 | 360,000 |
| Payments made on FHLB borrowings and other borrowings | (977,536) | (447,832) | (515,047) |
| FHLB advances prepayment fees | 8,536 | 4,872 | — |
| Proceeds from issuance of subordinated debt, net of issuance costs | — | — | 98,265 |
| Payments made on subordinated debt | (31,075) | (7,443) | (19,543) |
| Subordinated debt prepayment fees | — | 193 | 1,778 |
| Cash dividends paid on preferred stock | — | — | (191) |
| Redemption of preferred stock | — | (10) | (2,636) |
| Cash dividends paid on common stock | (25,172) | (24,958) | (23,599) |
| Common stock repurchased | (11,692) | (39,615) | (4,019) |
| Proceeds from issuance of common stock under employee benefit plans | 2,249 | 2,524 | 5,794 |
| Net cash provided by financing activities | 482,788 | 760,421 | 6,940 |
| Net increase (decrease) in cash and cash equivalents | 338,731 | (52,865) | 180,805 |
| Cash and cash equivalents: | | | |
| Beginning of period | 341,640 | 394,505 | 213,700 |
| End of period | \$ 680,371 | \$ 341,640 | \$ 394,505 |

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

MIDLAND STATES BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

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

Basis of Presentation

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and conform to predominant practices within the banking industry. Management of the Company has made a number of estimates and assumptions related to the reporting of assets and liabilities to prepare the consolidated financial statements in conformity with GAAP. Actual results may differ from those estimates. In the opinion of management, all adjustments, consisting of normal recurring accruals considered necessary for a fair presentation of the results of operations for annual periods presented herein, have been included. Certain reclassifications of 2020 and 2019 amounts have been made to conform to the 2021 presentation but do not have an effect on net income or shareholders’ equity.

Principles of Consolidation

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

Subsequent Events

Management has evaluated subsequent events for recognition and disclosure through February 25, 2022, which is the date the financial statements were available to be issued.

Business Combinations

The Company accounts for business combinations under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. Under the acquisition method of accounting, tangible and intangible identifiable assets acquired, liabilities assumed and any noncontrolling interests in the acquiree are recorded at fair value as of the acquisition date. The Company includes the results of operations of the acquired company in the consolidated statements of income from the date of acquisition. Transaction costs and costs to restructure the acquired company are expensed as incurred. Goodwill is recognized as the excess of the acquisition price over the estimated fair value of the net assets acquired. If the fair value of the net assets acquired is greater than the acquisition price, a bargain purchase gain is recognized and recorded in noninterest income.

Cash and Cash Equivalents and Cash Flows

For the presentation in the accompanying consolidated statement of cash flows, cash and cash equivalents are defined as cash on hand, amounts due from banks, which includes amounts on deposit with the Federal Reserve, interest-bearing deposits with banks or other financial institutions and federal funds sold. Generally, federal funds are sold for one-day periods, but not longer than 30 days.

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The following table summarizes supplemental cash flow information:

| (dollars in thousands) | Years Ended December 31, | | |
|----------------------------------------------------------------------------------------------------------|--------------------------|-----------|-----------|
| | 2021 | 2020 | 2019 |
| Supplemental disclosures of cash flow information: | | | |
| Cash payments for: | | | |
| Interest paid on deposits and borrowed funds | \$ 31,735 | \$ 47,712 | \$ 58,158 |
| Income tax paid, net of refunds | 7,759 | 2,977 | 479 |
| Supplemental disclosures of noncash investing and financing activities: | | | |
| Transfer of loans to loans held for sale | 123,117 | 542,060 | 419,215 |
| Transfer of loans to other real estate owned | 805 | 16,736 | 3,819 |
| Transfer of premises and equipment, net to assets held for sale | 23 | 11,344 | 4,350 |
| Transfer of loan servicing rights held for sale, at lower of cost or market to mortgage servicing rights | 705 | — | — |

Investment Securities

The Company classifies its debt investment securities as available for sale or held to maturity at the time of purchase. Securities held to maturity are those debt instruments which the Company has the positive intent and ability to hold until maturity. Securities held to maturity are recorded at cost, adjusted for the amortization of premiums or accretion of discounts. All other debt securities are classified as available for sale. As of December 31, 2021, all investment securities were classified as available for sale. Investment securities available for sale are recorded at fair value with the unrealized gains and losses, net of the related tax effect, included in other comprehensive income. The related accumulated unrealized holding gains and losses are reported as a separate component of shareholders' equity until realized.

Available-for-sale debt securities in an unrealized loss position are evaluated, at least quarterly, for impairment related to credit losses. The Company first assesses whether it intends to sell, or it is more likely than not that it will be required to sell, the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available for sale that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, and the present value of cash flows expected to be collected from the security is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recorded in other comprehensive income.

Changes in the allowance for credit losses are recorded as provision for, or reversal of, credit loss expense. Losses are charged against the allowance when management believes the uncollectability of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

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

Equity Securities

Investments in stock of a publicly traded company or in mutual funds are classified as equity securities. Equity securities are recorded at fair value with unrealized gains and losses recognized in net income.

Nonmarketable Equity Securities

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

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periodically evaluated for impairment based on ultimate recovery of par value. Both cash dividends and stock dividends are reported as income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are classified as portfolio loans. Portfolio loans are carried at the principal balance outstanding, net of purchase premiums and discounts, and deferred loan fees and costs. Interest income is accrued on the unpaid principal balance. Accrued interest receivable on loans totaled \$15.9 million and \$19.9 million at December 31, 2021 and 2020, respectively, and was reported in accrued interest receivable on the consolidated balance sheets.

Interest income on mortgage and commercial loans is discontinued and the loan is placed on nonaccrual status at the time the loan is 90 days delinquent unless the loan is well secured and in process of collection. Mortgage loans are charged off at 180 days past due, and commercial loans are charged-off to the extent principal or interest is deemed uncollectible. Consumer and credit card loans continue to accrue interest until they are charged off or at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cost-recovery or cash-basis method, until qualifying for return to accrual. Under the cost-recovery method, interest income is not recognized until the loan balance is reduced to zero. Under the cash-basis method, interest income is recorded when the payment is received in cash. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Leases. The Company provides financing leases to small businesses for purchases of business equipment. Under the direct financing method of accounting, the minimum lease payments to be received under the lease contract, together with the estimated unguaranteed residual values (approximately 3% to 15% of the cost of the related equipment), are recorded as lease receivables when the lease is signed and the leased property is delivered to the customer. The excess of the minimum lease payments and residual values over the cost of the equipment is recorded as unearned lease income. Unearned lease income is recognized over the term of the lease on a basis that results in an approximately level rate of return on the unrecovered lease investment.

Purchased Credit Deteriorated Loans. The Company has purchased loans, some of which have experienced more than insignificant credit deterioration since origination. PCD loans are recorded at the amount paid. An allowance for credit losses on loans is determined using the same methodology as other loans held for investment. The initial allowance for credit losses on loans determined on a collective basis is allocated to individual loans. The sum of the loan's purchase price and allowance for credit losses on loans becomes its initial amortized cost basis. The difference between the initial amortized cost basis and the par value of the loan is a noncredit discount or premium, which is amortized into interest income over the life of the loan. Subsequent changes to the allowance for credit losses on loans are recorded through provision expense for credit losses.

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

Allowance for Credit Losses on Loans

The Company adopted the current expected credit loss model under Accounting Standards Update ("ASU") 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13") on January 1, 2020 using the modified retrospective approach. Results for the periods beginning after January 1, 2020 are presented under ASU 2016-13 while prior period amounts are reported in accordance with the incurred loss model under previously applicable U.S. GAAP. The transition adjustment included an increase in the allowance for credit losses on loans of \$12.8 million and an increase in the allowance on unfunded commitments of \$0.3 million.

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The allowance for credit losses on loans is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. The amount of the allowance represents management's best estimate of current expected credit losses on loans considering available information, from internal and external sources, relevant to assessing collectibility over the loans' contractual terms, adjusted for expected prepayments when appropriate. The contractual term excludes expected extensions, renewals, and modifications, unless either of the following applies: management has a reasonable expectation at the reporting date that a troubled debt restructuring will be executed with an individual borrower or the extension or renewal options are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the Company.

Management estimates the allowance balance using relevant information, from internal and external sources, relating to historical credit loss experience, current conditions, and reasonable and supportable forecasts. While historical credit loss experience provides the basis for the estimation of expected credit losses, adjustments to historical loss information may be made for differences in current loan-specific risk characteristics, environmental conditions or other relevant factors. Allowance for credit losses on loans is measured on a collective basis and reflects impairment in groups of loans aggregated on the basis of similar risk characteristics. Loans that do not share risk characteristics are evaluated for expected credit losses on an individual basis and excluded from the collective evaluation. Expected credit losses for collateral dependent loans, including loans where the borrower is experiencing financial difficulty but foreclosure is not probable, are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate.

Credit loss expense related to loans reflects the totality of actions taken on all loans for a particular period including any necessary increases or decreases in the allowance related to changes in credit loss expectations associated with specific loans or pools of loans. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged-off. While management utilizes its best judgment and information available, the ultimate appropriateness of the allowance is dependent upon a variety of factors beyond our control, including the performance of our loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

In calculating the allowance for credit losses, most loans are segmented into pools based upon similar characteristics and risk profiles. Common characteristics and risk profiles may include internal credit ratings, risk ratings or classification, financial asset type, collateral type, size, industry of the borrower, historical or expected credit loss patterns, and reasonable and supportable forecast periods. For modeling purposes, our loan pools include (i) commercial, (ii) commercial real estate, (iii) construction and land development, (iv) residential real estate, (v) consumer, and (vi) lease financing. We periodically reassess each pool to ensure the loans within the pool continue to share similar characteristics and risk profiles and to determine whether further segmentation is necessary.

The table below identifies the Company's loan portfolio segments and classes.

| Segment | Class |
|-----------------------------------|----------------------------------------------------------------------------------------------------------------|
| Commercial | Commercial Commercial Other |
| Commercial Real Estate | Commercial Real Estate Non-Owner Occupied Commercial Real Estate Owner Occupied Multi-Family Farmland |
| Construction and Land Development | Construction and Land Development |
| Residential Real Estate | Residential First Lien Other Residential |
| Consumer | Consumer Consumer Other |
| Lease Financing | Lease Financing |

For each loan pool, we measure expected credit losses over the life of each loan utilizing a combination of models which measure (i) probability of default ("PD"), which is the likelihood that loan will stop performing or default, (ii) loss given default ("LGD"), which is the expected loss rate for loans in default, (iii) assumed prepayment speed, which is the likelihood that a loan will prepay or pay-off prior to maturity, and (iv) exposure at default ("EAD"), which is the estimated outstanding principal balance of the loans upon default, including the expected funding of unfunded commitments outstanding as of the

measurement date. For certain commercial loan portfolios, the PD is calculated using a transition matrix to determine the likelihood of a customer's risk grade migrating from one specified range of risk grades to a different specified range. Expected credit losses are calculated as the product of PD (adjusted for prepayment), LGD and EAD. This methodology builds on default probabilities already incorporated into our risk grading process by utilizing pool-specific historical loss rates to calculate expected credit losses. These pool-specific historical loss rates may be adjusted for current macroeconomic assumptions, as further discussed below, and other factors such as differences in underwriting standards, portfolio mix, or when historical asset terms do not reflect the contractual terms of the financial assets being evaluated as of the measurement date. Each time we measure expected credit losses, we assess the relevancy of historical loss information and consider any necessary adjustments to address any differences in asset-specific characteristics.

The measurement of expected credit losses is impacted by loan and borrower attributes and certain macroeconomic variables. Significant loan and borrower attributes utilized in our modeling processes include, among other things, (i) origination date, (ii) maturity date, (iii) payment type, (iv) collateral type and amount, (v) current risk grade, (vi) current unpaid balance and commitment utilization rate, (vii) payment status and delinquency history and (viii) expected recoveries of previously charged-off amounts. Significant macroeconomic variables utilized in our modeling processes include, among other things, (i) US and Illinois Disposable Income and Gross Domestic Product, (ii) selected market interest rates including U.S. Treasury rates and government bond rates, (iii) Consumer Price Index, (iv) commercial and residential property prices in Illinois and the US as a whole, and (v) Illinois Housing Starts and Retail Sales for the State of Illinois and US.

The probability of default and prepayment assumptions were estimated by analyzing internally-sourced data related to historical performance of each loan pool. They are adjusted to reflect the current impact of certain macroeconomic variables as well as their expected changes over a reasonable and supportable forecast period. We have determined that we are reasonably able to forecast the macroeconomic variables used in our modeling processes with an acceptable degree of confidence for a total of two years with the last twelve months of the forecast period encompassing a reversion process whereby the forecasted macroeconomic variables are reverted to their historical mean utilizing a straight line basis. The macroeconomic variables utilized as inputs in our modeling processes were subjected to a variety of analysis procedures and were selected primarily based on statistical relevancy and correlation to our historical credit losses. By reverting these modeling inputs to their historical mean and considering loan and borrower specific attributes, our models are intended to yield a measurement of expected credit losses that reflects our average historical loss rates for periods subsequent to the twelve-month reversion period. The LGD is based on historical recovery averages for each loan pool, adjusted to reflect the current impact of certain macroeconomic variables as well as their expected changes over a two-year forecast period, with the final twelve months of the forecast period encompassing a reversion process, which management considers to be both reasonable and supportable. The same forecast and reversion periods are used for all macroeconomic variables in our models.

Management qualitatively adjusts model results for risk factors that are not considered within our modeling processes but are nonetheless relevant in assessing the expected credit losses within our loan pools. These qualitative factor ("Q-Factor") adjustments may increase or decrease management's estimate of expected credit losses by a calculated percentage or amount based upon the estimated level of risk. The various risks that may be considered in making Q-Factor adjustments include, among other things, the impact of (i) changes in lending policies and procedures, including changes in underwriting standards and practices for collections, write-offs, and recoveries, (ii) actual and expected changes in economic and business conditions and developments that affect the collectibility of the loan pools, (iii) changes in the nature and volume of the loan pools and in the terms of the underlying loans, (iv) changes in the experience, ability, and depth of our lending management and staff, (v) changes in volume and severity of past due financial assets, the volume of non-accrual assets, and the volume and severity of adversely classified or graded assets, (vi) changes in the quality of our credit review function, (vii) changes in the value of the underlying collateral for loans that are non-collateral dependent, (viii) the existence, growth, and effect of any concentrations of credit and (ix) other factors such as the regulatory, legal and technological environments; competition; and events such as natural disasters or health pandemics.

In some cases, management may determine that an individual loan exhibits unique risk characteristics which differentiate the loan from other loans within our loan pools. In such cases, the loans are evaluated for expected credit losses on an individual basis and excluded from the collective evaluation. Specific allocations of the allowance for credit losses are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things. A loan is considered to be collateral dependent when, based upon management's assessment, the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral. In such cases, expected credit losses are based on the fair value of the collateral at the measurement date, adjusted for estimated selling costs if satisfaction of the loan depends on the sale of the collateral. We reevaluate the fair value of collateral supporting collateral dependent loans on a quarterly basis.

Specific reserves reflect expected credit losses on loans identified for evaluation or individually considered nonperforming. These loans no longer have similar risk characteristics to collectively evaluated loans due to changes in credit

risk, borrower circumstances, recognition of write-offs, or cash collections that have been fully applied to principal on the basis of nonaccrual policies. At a minimum, the population of loans subject to individual evaluation include individual loans where it is probable we will be unable to collect all amounts due, according to the original contractual terms. These include, nonaccrual loans with a balance greater than \$500,000, accruing loans 90 days past due or greater with a balance greater than \$100,000, specialty lending relationships and other loans as determined by management. Allowance for credit losses for consumer and residential loans are, primarily, determined by meaningful pools of similar loans and are evaluated on a quarterly basis.

The provision for credit losses on loans individually evaluated is recognized on the basis of the present value of expected future cash flows discounted at the effective interest rate, the fair value of collateral adjusted for estimated costs to sell, or the observable market price as of the relevant date. Allowance for credit losses on loans adjustments for estimated costs to sell are not appropriate when the repayment of the collateral-dependent loan is expected from the operation of the collateral.

Loans Held for Sale

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

Mortgage Repurchase Reserve

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

Premises and Equipment

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

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

Operating Lease Right of Use Assets and Liabilities

The Company determines if a lease is present at the inception of an agreement. Operating leases are capitalized at commencement and are discounted using the Company's FHLB borrowing rate for a similar term borrowing unless the lease defines an implicit rate within the contract.

The operating lease right of use assets represent the Company's right to use an underlying asset for the lease term, and the operating lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease right of use assets and operating lease liabilities are recognized on the lease commencement date based on the present value of lease payments over the lease term. No significant judgments or assumptions were involved in developing the estimated operating lease liabilities as the Company's operating lease liabilities largely represent future rental expenses associated with operating leases and the borrowing rates are based on publicly available interest rates.

Other Real Estate Owned

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

Goodwill and Intangible Assets

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

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

Loan Servicing Rights

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

Loan servicing rights do not trade in an active market with readily observable prices. The fair value of loan servicing rights and their sensitivity to changes in interest rates is influenced by the mix of the servicing portfolio and characteristics of each segment of the portfolio. The Company’s servicing portfolio consists of distinct portfolios of government-insured residential and commercial mortgages, conventional residential mortgages and Small Business Administration (“SBA”) loans. The Company periodically evaluates its loan servicing rights asset for impairment. Impairment is assessed based on the fair value of net servicing cash flows at each reporting date using estimated prepayment speeds of the underlying loans serviced and stratifications based on the risk characteristics of the underlying loans. The fair value of our servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, replacement reserves and other economic factors which are determined based on current market conditions. To the extent the amortized cost of the mortgage servicing rights exceeds the estimated fair value by stratification, the Company records an impairment expense and reduces the carrying value of the loan servicing rights.

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

Cash Surrender Value of Life Insurance Policies

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

Derivative Financial Instruments

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

We formally document all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as cash flow hedges to specific assets and liabilities on the balance sheet or forecasted transactions. We also formally assess, both at the hedge’s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

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

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

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

Allowance for Credit Losses on Unfunded Commitments

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

The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk via a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the Company. The allowance for credit losses on unfunded commitments is adjusted as a provision for credit loss expense on the consolidated income statement. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life. Expected utilization rates are compared to the current funded portion of the total commitment amount as a practical expedient for funded exposure at default. The allowance for credit losses on unfunded commitments totaled \$1.9 million and \$2.4 million at December 31, 2021 and 2020, respectively.

Income Taxes

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

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

When tax returns are filed, it is highly certain that some positions taken will be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the consolidated financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized upon settlement with the applicable taxing authority. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in other income or expense. The Company evaluated its tax positions and concluded that it had taken no uncertain tax positions that require adjustment in the consolidated financial statements.

Share-Based Compensation Plans

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

Comprehensive Income

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

Earnings per Share

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

Accounting Guidance Adopted in 2021

FASB ASU No. 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes – In December 2019, the Financial Accounting Standard Board ("FASB") issued ASU No. 2019-12 which removes specific exceptions to the general principles in Topic 740 in GAAP. It eliminates the need for an organization to analyze whether the following apply in a given period: (1) exception to the incremental approach for intraperiod tax allocation; (2) exceptions to accounting for basis differences when there are ownership changes in foreign investments; and (3) exception in interim period income tax accounting for year-to-date losses that exceed anticipated losses. The ASU also improves financial statement preparers' application of income tax-related guidance and simplifies GAAP for: (1) franchise taxes that are partially based on income; (2) transactions with a government that result in a step up in the tax basis of goodwill; (3) separate financial statements of legal entities that are not subject to tax; and (4) enacted changes in tax laws in interim periods. The amendments in this update became effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. The adoption of ASU 2019-12 on January 1, 2021 did not have a material impact on the Company's consolidated financial statements.

FASB ASU No. 2020-01, Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): Clarifying the Interactions Between Topic 321, Topic 323 and Topic 815 (a Consensus of the Emerging Issues Task Force) – In January 2020, the FASB issued ASU No. 2020-01 which clarifies the interactions ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities and the ASU on equity method investments. ASU 2016-01 provides companies with an alternative to measure certain equity securities without a readily determinable fair value at cost, minus impairment, if any, unless an observable transaction for an identical or similar security occurs. ASU 2020-01 clarifies that for purposes of applying the Topic 321 measurement alternative, an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting under Topic 323, immediately before applying or upon discontinuing the equity method. In addition, the new ASU provides direction that a company should not consider whether the underlying securities would be accounted for under the equity method or the fair value option when it is determining the accounting for certain forward contracts and purchased options, upon either settlement or exercise. The Company uses the equity method of accounting for investments in limited partnerships and has concluded this is the correct method of accounting.

for these investments. The amendments in this update became effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. The amendments are to be applied prospectively and did not have a material impact on the consolidated financial statements.

Accounting Guidance Issued But Not Yet Adopted

FASB ASU No. 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting – In March 2020, the FASB issued ASU No. 2020-04 which provides optional expedients and exceptions for accounting related to contracts, hedging relationships and other transactions affected by reference rate reform if certain criteria are met. ASU 2020-04 applies only to contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform and do not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022, except for hedging relationships existing as of December 31, 2022, that an entity has elected certain optional expedients for and that are retained through the end of the hedging relationship. ASU 2020-04 was effective upon issuance and generally can be applied through December 31, 2022.

The Company has been monitoring its volume of commercial loans tied to LIBOR. In 2021, the Company began prioritizing SOFR as the preferred alternative reference rate with plans to cease booking LIBOR based commitments after the end of 2021. Loans with a maturity after June 2023 are being reviewed and monitored to ensure there is appropriate fallback language in place when LIBOR is no longer published. Loans with a maturity date before that time should naturally mature and be re-underwritten with the alternative index rate.

In January 2021, the FASB issued ASU 2021-01, Reference Rate Reform (Topic 848): Scope, which addresses questions about whether Topic 848 can be applied to derivative instruments that do not reference a rate that is expected to be discontinued but that use an interest rate for margining, discounting, or contract price alignment that is expected to be modified as a result of reference rate reform, commonly referred to as the "discounting transition". The amendments clarify that certain optional expedients and exceptions in Topic 848 do apply to derivatives that are affected by the discounting transition. The amendments in ASU 2021-01 are effective immediately.

The Company believes the adoption of this guidance on activities subsequent to December 31, 2021 through December 31, 2022 will not have a material impact on the consolidated financial statements.

NOTE 2 – ACQUISITIONS AND DISPOSITIONS

ATG Trust Company

On June 1, 2021, the Company completed its acquisition of substantially all of the trust assets of ATG Trust, a trust company based in Chicago, Illinois, with approximately \$399.7 million in assets under management. In aggregate, the Company acquired the assets of ATG Trust for \$2.7 million in cash. The acquisition was accounted for under the acquisition method of accounting. Accordingly, the Company recognized amounts for identifiable assets acquired at their estimated acquisition date fair values, while \$0.4 million of transaction and integration costs associated with the acquisition were expensed during 2021.

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A summary of the fair value of the assets acquired, liabilities assumed and resulting goodwill are included in the table below.

| (dollars in thousands) | ATG |
|--------------------------------------------|-----------------|
| Assets acquired: | |
| Intangible assets | \$ 1,847 |
| Other assets | 1,269 |
| Total assets acquired | <u>3,116</u> |
| Liabilities assumed: | |
| Other liabilities | 401 |
| Net assets acquired and consideration paid | <u>\$ 2,715</u> |
| Intangible assets: | |
| Customer relationship intangible | \$ 1,847 |
| Estimated useful life | 6 years |

The identifiable assets acquired from ATG Trust included customer relationship intangibles are being amortized on a straight line basis as shown above.

Commercial FHA Origination Platform

On August 28, 2020, the Company announced that it had completed the sale of its commercial FHA origination platform to Dwight Capital, a nationwide mortgage banking firm headquartered in New York. The Company received proceeds of \$7.5 million for the sale of the commercial FHA origination platform, owned by our subsidiary, Love Funding. As part of the asset sale, goodwill of \$10.9 million was derecognized and was not deductible for tax purposes, generating tax expense of \$3.0 million.

NOTE 3 – CASH AND DUE FROM BANKS

The Bank is required to maintain cash reserves based on the level of certain of its deposit accounts. This reserve requirement may be met by funds on deposit with the FRB and cash on hand. In response to the COVID pandemic, the Federal Reserve lowered the reserve requirement ratios to 0% effective March 26, 2020, and therefore, the Bank had no required reserve balance at December 31, 2021 and 2020.

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

NOTE 4 – INVESTMENT SECURITIES

Investment Securities Available for Sale

Investment securities available for sale at December 31, 2021 and 2020 were as follows:

| (dollars in thousands) | 2021 | | | | | |
|---------------------------------------------------------------|-------------------|------------------------|-------------------------|-----------------------------|-------------------|--|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses | Allowance for credit losses | Fair value | |
| Investment securities available for sale | | | | | | |
| U.S. Treasury securities | \$ 65,347 | \$ — | \$ 430 | \$ — | \$ 64,917 | |
| U.S. government sponsored entities and U.S. agency securities | 34,569 | 79 | 831 | — | 33,817 | |
| Mortgage-backed securities - agency | 444,484 | 2,687 | 6,901 | — | 440,270 | |
| Mortgage-backed securities - non-agency | 29,037 | 50 | 381 | — | 28,706 | |
| State and municipal securities | 137,904 | 5,561 | 366 | — | 143,099 | |
| Corporate securities | 193,354 | 3,128 | 467 | 221 | 195,794 | |
| Total investment securities available for sale | <u>\$ 904,695</u> | <u>\$ 11,505</u> | <u>\$ 9,376</u> | <u>\$ 221</u> | <u>\$ 906,603</u> | |

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| (dollars in thousands) | 2020 | | | | | Allowance for credit losses | Fair value |
|---------------------------------------------------------------|-------------------|------------------------|-------------------------|---------------|------|-----------------------------|------------|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses | | | | |
| Investment securities available for sale | | | | | | | |
| U.S. government sponsored entities and U.S. agency securities | \$ 35,287 | \$ 377 | \$ 97 | \$ — | \$ — | \$ 35,567 | |
| Mortgage-backed securities - agency | 338,340 | 6,284 | 47 | — | — | 344,577 | |
| Mortgage-backed securities - non-agency | 20,411 | 333 | — | — | — | 20,744 | |
| State and municipal securities | 122,488 | 7,311 | 5 | 29 | — | 129,765 | |
| Corporate securities | 145,187 | 2,205 | 997 | 337 | — | 146,058 | |
| Total investment securities available for sale | <u>\$ 661,713</u> | <u>\$ 16,510</u> | <u>\$ 1,146</u> | <u>\$ 366</u> | — | <u>\$ 676,711</u> | |

Investment securities with a carrying amount of \$371.0 million and \$327.0 million were pledged for public deposits at December 31, 2021 and 2020, respectively.

The following is a summary of the amortized cost and fair value of investment securities available for sale, by maturity, at December 31, 2021. Expected maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be prepaid without penalties. The maturities of all other investment securities available for sale are based on final contractual maturity.

| (dollars in thousands) | Amortized cost | Fair value |
|-------------------------------------------------|-------------------|-------------------|
| Investment securities available for sale | | |
| Within one year | \$ 9,877 | \$ 9,976 |
| After one year through five years | 137,694 | 139,456 |
| After five years through ten years | 244,626 | 248,197 |
| After ten years | 38,977 | 39,998 |
| Mortgage-backed securities | 473,521 | 468,976 |
| Total investment securities available for sale | <u>\$ 904,695</u> | <u>\$ 906,603</u> |

Proceeds from the sale of investment securities available for sale and the resulting gross realized gains and losses for the years ended December 31, 2021, 2020 and 2019 are summarized below:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|-------------------------------------------------|-----------|-----------|-----------|
| Investment securities available for sale | | | |
| Proceeds from sales | \$ 14,777 | \$ 28,256 | \$ 33,464 |
| Gross realized gains on sales | 537 | 1,721 | 786 |
| Gross realized losses on sales | — | — | (190) |

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The table below presents a rollforward by major security type for the year ended December 31, 2021 of the allowance for credit losses on investment securities available for sale held at period end:

| (dollars in thousands) | State and municipal securities | Corporate securities | Total |
|--------------------------------------------------------------------|--------------------------------|----------------------|--------|
| Changes in ACL on investment securities available for sale: | | | |
| For the year ended December 31, 2021 | | | |
| Balance, beginning of period | \$ 29 | \$ 337 | \$ 366 |
| Current-period recapture of expected credit losses | (29) | (116) | (145) |
| Balance, end of period | \$ — | \$ 221 | \$ 221 |
| For the year ended December 31, 2020 | | | |
| Balance, beginning of period | \$ — | \$ — | \$ — |
| Current-period provision for expected credit losses | 29 | 337 | 366 |
| Balance, end of period | \$ 29 | \$ 337 | \$ 366 |

Unrealized losses and fair values for investment securities available for sale at December 31, 2021 and 2020, for which an allowance for credit losses has not been recorded, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are summarized as follows:

| (dollars in thousands) | 2021 | | | | | |
|---------------------------------------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
| | Less than 12 Months | | 12 Months or more | | Total | |
| | Fair value | Unrealized loss | Fair value | Unrealized loss | Fair value | Unrealized loss |
| Investment securities available for sale | | | | | | |
| U.S. Treasury securities | \$ 64,917 | \$ 430 | \$ — | \$ — | \$ 64,917 | \$ 430 |
| U.S. government sponsored entities and U.S. agency securities | 17,487 | 263 | 9,432 | 568 | 26,919 | 831 |
| Mortgage-backed securities - agency | 317,372 | 6,633 | 9,051 | 268 | 326,423 | 6,901 |
| Mortgage-backed securities - non-agency | 24,095 | 381 | — | — | 24,095 | 381 |
| State and municipal securities | 27,324 | 270 | 2,538 | 96 | 29,862 | 366 |
| Corporate securities | — | — | — | — | — | — |
| Total investment securities available for sale | \$ 451,195 | \$ 7,977 | \$ 21,021 | \$ 932 | \$ 472,216 | \$ 8,909 |
| 2020 | | | | | | |
| (dollars in thousands) | Less than 12 Months | | 12 Months or more | | Total | |
| | Fair value | Unrealized loss | Fair value | Unrealized loss | Fair value | Unrealized loss |
| | \$ 9,903 | \$ 97 | \$ — | \$ — | \$ 9,903 | \$ 97 |
| Investment securities available for sale | | | | | | |
| U.S. government sponsored entities and U.S. agency securities | \$ 9,903 | \$ 97 | \$ — | \$ — | \$ 9,903 | \$ 97 |
| Mortgage-backed securities - agency | 26,172 | 47 | — | — | 26,172 | 47 |
| Corporate securities | 20,010 | 522 | — | — | 20,010 | 522 |
| Total investment securities available for sale | \$ 56,085 | \$ 666 | \$ — | \$ — | \$ 56,085 | \$ 666 |

For all of the above investment securities available for sale, the unrealized losses are principally related to fluctuations in the current interest rate environment, and unrealized losses are considered to be temporary as the fair value is expected to recover as the securities approach their respective maturity dates. At December 31, 2021, 113 investment securities available for sale had unrealized losses with aggregate depreciation of 1.85% from their amortized cost basis. In analyzing an issuer's financial condition, we consider whether the securities are issued by the federal government or its agencies and whether downgrades by bond rating agencies have occurred. The Company does not intend to sell and it is likely that the Company will not be required to sell the securities prior to their anticipated recovery.

Equity Securities

Equity securities are recorded at fair value and totaled \$9.5 million and \$9.4 million at December 31, 2021 and 2020, respectively.

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Proceeds and gross realized gains and losses on sales of equity securities as well as net unrealized gains and losses on equity securities for the years ended December 31, 2021, 2020 and 2019 are summarized below:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|--------------------------------|------|------|--------|
| Equity securities | | | |
| Proceeds from sales | \$ — | \$ — | \$ 105 |
| Gross realized gains on sales | — | — | 78 |
| Gross realized losses on sales | — | — | — |
| Net unrealized gains (losses) | 361 | 577 | 93 |

Net unrealized gains and losses on equity securities were recorded in other income in the consolidated statements of income.

NOTE 5 – LOANS

The following table presents total loans outstanding by portfolio class, at December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | 2020 |
|-------------------------------------------|---------------------|---------------------|
| Commercial: | | |
| Commercial | \$ 770,670 | \$ 937,382 |
| Commercial other | 679,518 | 748,193 |
| Commercial real estate: | | |
| Commercial real estate non-owner occupied | 1,105,333 | 871,451 |
| Commercial real estate owner occupied | 469,658 | 423,257 |
| Multi-family | 171,875 | 151,534 |
| Farmland | 69,962 | 79,731 |
| Construction and land development | 193,749 | 172,737 |
| Total commercial loans | 3,460,765 | 3,384,285 |
| Residential real estate: | | |
| Residential first lien | 274,412 | 358,329 |
| Other residential | 63,739 | 84,551 |
| Consumer: | | |
| Consumer | 106,008 | 80,642 |
| Consumer other | 896,597 | 785,460 |
| Lease financing | 423,280 | 410,064 |
| Total loans, gross | <u>\$ 5,224,801</u> | <u>\$ 5,103,331</u> |

Total loans include net deferred loan costs of \$4.6 million and \$0.7 million at December 31, 2021 and 2020, respectively, and unearned discounts of \$46.1 million and \$46.5 million within the lease financing portfolio at December 31, 2021 and 2020, respectively.

At December 31, 2021 and 2020, the Company had commercial real estate and residential real estate loans held for sale totaling \$32.0 million and \$138.1 million, respectively. During the years ended December 31, 2021 and 2020, the Company sold commercial real estate, residential real estate and consumer loans with proceeds totaling \$740.0 million and \$1.22 billion, respectively.

Classifications of Loan Portfolio

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

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

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equipment, inventory, accounts receivable, and other sources of repayment. PPP loans of \$52.5 million and \$184.4 million as of December 31, 2021 and 2020, respectively, and commercial FHA warehouse lines of \$91.9 million and \$273.3 million as of December 31, 2021 and 2020, respectively, and were included in this classification.

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

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

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

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

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

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

We have extended loans to certain of our directors, executive officers, principal shareholders and their affiliates. These loans were made in the ordinary course of business upon normal terms, including collateralization and interest rates prevailing at the time. The aggregate loans outstanding to the Company's directors, executive officers, principal shareholders and their affiliates totaled \$13.9 million and \$19.7 million at December 31, 2021 and 2020, respectively. The new loans, other additions, repayments and other reductions for the years ended December 31, 2021 and 2020, are summarized as follows:

| (dollars in thousands) | 2021 | 2020 |
|---------------------------------|------------------|------------------|
| Beginning balance | \$ 19,693 | \$ 22,989 |
| New loans and other additions | 4,745 | 2,563 |
| Repayments and other reductions | (10,569) | (5,859) |
| Ending balance | <u>\$ 13,869</u> | <u>\$ 19,693</u> |

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The following table presents, by loan portfolio, a summary of changes in the allowance for credit losses on loans for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | Commercial Loan Portfolio | | | | Other Loan Portfolio | | | | | |
|-----------------------------------------------------------------|---------------------------|------------------|----------------------|-----------------|----------------------|-----------------|------------------|-------|--|--|
| | Commercial | | Construction | Residential | Real Estate | | Lease Financing | Total | | |
| | Commercial | Real Estate | and Land Development | | Consumer | | | | | |
| Changes in allowance for credit losses on loans in 2021: | | | | | | | | | | |
| Balance, beginning of period | \$ 19,851 | \$ 25,465 | \$ 1,433 | \$ 3,929 | \$ 2,338 | \$ 7,427 | \$ 60,443 | | | |
| Provision for credit losses on loans | 648 | 1,031 | (234) | (1,085) | 864 | 2,726 | 3,950 | | | |
| Charge-offs | (6,465) | (3,524) | (448) | (398) | (1,158) | (3,427) | (15,420) | | | |
| Recoveries | 341 | 21 | 221 | 249 | 514 | 743 | 2,089 | | | |
| Balance, end of period | <u>\$ 14,375</u> | <u>\$ 22,993</u> | <u>\$ 972</u> | <u>\$ 2,695</u> | <u>\$ 2,558</u> | <u>\$ 7,469</u> | <u>\$ 51,062</u> | | | |
| Changes in allowance for credit losses on loans in 2020: | | | | | | | | | | |
| Balance, beginning of period | \$ 10,031 | \$ 10,272 | \$ 290 | \$ 2,499 | \$ 2,642 | \$ 2,294 | \$ 28,028 | | | |
| Impact of adopting ASC 326 | 2,327 | 4,104 | 724 | 1,211 | (594) | 774 | 8,546 | | | |
| Impact of adopting ASC 326 - PCD loans | 1,045 | 1,311 | 809 | 1,015 | 57 | — | 4,237 | | | |
| Provision for credit losses on loans | 11,890 | 23,091 | (121) | (458) | 1,212 | 7,535 | 43,149 | | | |
| Charge-offs | (5,589) | (13,637) | (376) | (522) | (1,624) | (3,706) | (25,454) | | | |
| Recoveries | 147 | 324 | 107 | 184 | 645 | 530 | 1,937 | | | |
| Balance, end of period | <u>\$ 19,851</u> | <u>\$ 25,465</u> | <u>\$ 1,433</u> | <u>\$ 3,929</u> | <u>\$ 2,338</u> | <u>\$ 7,427</u> | <u>\$ 60,443</u> | | | |
| Changes in allowance for credit losses on loans in 2019: | | | | | | | | | | |
| Balance, beginning of period | \$ 9,524 | \$ 4,723 | \$ 372 | \$ 2,041 | \$ 2,154 | \$ 2,089 | \$ 20,903 | | | |
| Provision for credit losses on loans | 3,852 | 7,939 | (53) | 1,392 | 1,767 | 2,088 | 16,985 | | | |
| Charge-offs | (3,412) | (3,339) | (44) | (1,076) | (1,946) | (2,251) | (12,068) | | | |
| Recoveries | 67 | 949 | 15 | 142 | 667 | 368 | 2,208 | | | |
| Balance, end of period | <u>\$ 10,031</u> | <u>\$ 10,272</u> | <u>\$ 290</u> | <u>\$ 2,499</u> | <u>\$ 2,642</u> | <u>\$ 2,294</u> | <u>\$ 28,028</u> | | | |

The Company utilizes a combination of models with measure probability of default and loss given default methodology in determining expected future credit losses.

The probability of default is the risk that the borrower will be unable or unwilling to repay its debt in full or on time. The risk of default is derived by analyzing the obligor's capacity to repay the debt in accordance with contractual terms. Probability of default is generally associated with financial characteristics such as inadequate cash flow to service debt, declining revenues or operating margins, high leverage, declining or marginal liquidity, and the inability to successfully implement a business plan. In addition to these quantifiable factors, the borrower's willingness to repay also must be evaluated.

The probability of default is forecasted, for most commercial and retail loans, using a regression model that determine the likelihood of default within the twelve month time horizon. The regression model uses forward-looking economic forecasts including variables such as gross domestic product, housing price index, and real disposable income to predict default rates. The forecasting method for the equipment financing portfolio assumes a rolling twelve month average of the through-the-cycle default mean, to predict default rates for the twelve month time horizon.

The loss given default component is the percentage of defaulted loan balance that is ultimately charged off. As a method for estimating the allowance, a form of migration analysis is used that combines the estimated probability of loans experiencing default events and the losses ultimately associated with the loans experiencing those defaults. Multiplying one by the other gives the Company its loss rate, which is then applied to the loan portfolio balance to determine expected future losses.

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Within the model, the loss given default approach produces segmented loss given default estimates using a loss curve methodology, which is based on historical net losses from charge-off and recovery information. The main principle of a loss curve model is that the loss follows a steady timing schedule based on how long the defaulted loan has been on the books.

The Company's expected loss estimate is anchored in historical credit loss experience, with an emphasis on all available portfolio data. The Company's historical look-back period includes January 2012 through the current period, on a monthly basis. When historical credit loss experience is not sufficient for a specific portfolio, the Company may supplement its own portfolio data with external models or data.

Historical data is evaluated in multiple components of the expected credit loss, including the reasonable and supportable forecast and the post-reversion period of each loan segment. The historical experience is used to infer probability of default and loss given default in the reasonable and supportable forecast period. In the post-reversion period, long-term average loss rates are segmented by loan pool.

Qualitative reserves reflect management's overall estimate of the extent to which current expected credit losses on collectively evaluated loans will differ from historical loss experience. The analysis takes into consideration other analytics performed within the organization, such as enterprise and concentration management, along with other credit-related analytics as deemed appropriate. Management attempts to quantify qualitative reserves whenever possible.

The Company segments the loan portfolio into pools based on the following risk characteristics: financial asset type, collateral type, loan characteristics, credit characteristics, outstanding loan balances, contractual terms and prepayment assumptions, industry of borrower and concentrations, historical or expected credit loss patterns, and reasonable and supportable forecast periods.

Within the probability of default segmentation, credit metrics are identified to further segment the financial assets. The Company utilizes risk ratings for the commercial portfolios and days past due for the consumer and the lease financing portfolios.

The Company has defined five transitioning risk states for each asset pool within the expected credit loss model. The below table illustrates the transition matrix:

| Risk state | Commercial loans risk rating | Consumer loans and equipment finance loans and leases days past due |
|------------|---------------------------------|---------------------------------------------------------------------------|
| 1 | 0-5 | 0-14 |
| 2 | 6 | 15-29 |
| 3 | 7 | 30-59 |
| 4 | 8 | 60-89 |
| Default | 9+ and nonaccrual | 90+ and nonaccrual |

Expected Credit Losses

In calculating expected credit losses, the Company individually evaluates loans on nonaccrual status with a balance greater than \$500,000, loans past due 90 days or more and still accruing interest, and loans that do not share risk characteristics

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with other loans in the pool. The following table presents the amortized cost basis of individually evaluated loans on nonaccrual status as of December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | | | 2020 | | |
|-------------------------------------------|---------------------------------|------------------------------------|---------------------|---------------------------------|------------------------------------|---------------------|
| | Nonaccrual with Allowance | Nonaccrual with no Allowance | Total Nonaccrual | Nonaccrual with Allowance | Nonaccrual with no Allowance | Total Nonaccrual |
| | | | | | | |
| Commercial: | | | | | | |
| Commercial | \$ 4,681 | \$ 2,275 | \$ 6,956 | \$ 3,498 | \$ — | \$ 3,498 |
| Commercial Other | 4,467 | — | 4,467 | 2,634 | — | 2,634 |
| Commercial real estate: | | | | | | |
| Commercial real estate non-owner occupied | 1,914 | 9,912 | 11,826 | 5,509 | 3,823 | 9,332 |
| Commercial real estate owner occupied | 2,164 | 1,340 | 3,504 | 3,598 | 3,227 | 6,825 |
| Multi-family | 201 | 1,967 | 2,168 | 7,921 | 2,325 | 10,246 |
| Farmland | 155 | — | 155 | — | — | — |
| Construction and land development | 83 | — | 83 | 2,131 | 693 | 2,824 |
| Total commercial loans | 13,665 | 15,494 | 29,159 | 25,291 | 10,068 | 35,359 |
| Residential real estate: | | | | | | |
| Residential first lien | 3,116 | 832 | 3,948 | 8,534 | 1,071 | 9,605 |
| Other residential | 836 | — | 836 | 2,437 | — | 2,437 |
| Consumer: | | | | | | |
| Consumer | 110 | — | 110 | 262 | — | 262 |
| Lease financing | 1,510 | — | 1,510 | 1,965 | — | 1,965 |
| Total loans | \$ 19,237 | \$ 16,326 | \$ 35,563 | \$ 38,489 | \$ 11,139 | \$ 49,628 |

During the first quarter of 2020, as part of the adoption of CECL, \$9.8 million of PCD loans were reclassified to nonaccrual loans.

There was no interest income recognized on nonaccrual loans during the years ended December 31, 2021, 2020 and 2019 while the loans were in nonaccrual status. Additional interest income that would have been recorded on nonaccrual loans had they been current in accordance with their original terms was \$2.7 million, \$3.3 million and \$2.2 million during the years ended December 31, 2021, 2020 and 2019, respectively. The Company recognized interest income on commercial and commercial real estate loans modified under troubled debt restructurings of \$0.1 million during each of the years ended December 31, 2021, 2020 and 2019.

Collateral Dependent Financial Assets

A collateral dependent financial loan relies solely on the operation or sale of the collateral for repayment. In evaluating the overall risk associated with a loan, the Company considers character, overall financial condition and resources, and payment record of the borrower; the prospects for support from any financially responsible guarantors; and the nature and degree of protection provided by the cash flow and value of any underlying collateral. However, as other sources of repayment become inadequate over time, the significance of the collateral's value increases and the loan may become collateral dependent.

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The table below presents the value of individually evaluated, collateral dependent loans by loan class, for borrowers experiencing financial difficulty, as of December 31, 2021 and 2020:

| (dollars in thousands) | Type of Collateral | | | | | |
|-------------------------------------------|--------------------|--------------|-----------|-----------|--|--|
| | Real Estate | Blanket Lien | Equipment | Total | | |
| December 31, 2021 | | | | | | |
| Commercial: | | | | | | |
| Commercial | \$ — | \$ 5,402 | \$ — | \$ 5,402 | | |
| Commercial other | — | — | 502 | 502 | | |
| Commercial real estate: | | | | | | |
| Commercial real estate non-owner occupied | 11,604 | — | — | 11,604 | | |
| Commercial real estate owner occupied | 1,336 | — | — | 1,336 | | |
| Multi-Family | 1,969 | — | — | 1,969 | | |
| Total Collateral Dependent Loans | \$ 14,909 | \$ 5,402 | \$ 502 | \$ 20,813 | | |
| December 31, 2020 | | | | | | |
| Commercial real estate: | | | | | | |
| Commercial real estate non-owner occupied | 8,159 | — | — | 8,159 | | |
| Multi-Family | 10,121 | — | — | 10,121 | | |
| Construction and land development | 693 | — | — | 693 | | |
| Total Collateral Dependent Loans | \$ 18,973 | \$ — | \$ — | \$ 18,973 | | |

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The aging status of the recorded investment in loans by portfolio as of December 31, 2021 was as follows:

| (dollars in thousands) | Accruing Loans | | | Total past due loans | Nonaccrual loans | Current loans | Total loans |
|-------------------------------------------|---------------------|---------------------|--------------------------|----------------------|------------------|---------------|--------------|
| | 30-59 days past due | 60-89 days past due | Past due 90 days or more | | | | |
| Commercial: | | | | | | | |
| Commercial | \$ 283 | \$ 1,082 | \$ — | \$ 1,365 | \$ 6,956 | \$ 762,349 | \$ 770,670 |
| Commercial other | 2,402 | 2,110 | 5 | 4,517 | 4,467 | 670,534 | 679,518 |
| Commercial real estate: | | | | | | | |
| Commercial real estate non-owner occupied | 585 | 243 | — | 828 | 11,826 | 1,092,679 | 1,105,333 |
| Commercial real estate owner occupied | 232 | 730 | — | 962 | 3,504 | 465,192 | 469,658 |
| Multi-family | — | — | — | — | 2,168 | 169,707 | 171,875 |
| Farmland | — | 26 | — | 26 | 155 | 69,781 | 69,962 |
| Construction and land development | 195 | 195 | — | 390 | 83 | 193,276 | 193,749 |
| Total commercial loans | 3,697 | 4,386 | 5 | 8,088 | 29,159 | 3,423,518 | 3,460,765 |
| Residential real estate: | | | | | | | |
| Residential first lien | 113 | 285 | — | 398 | 3,948 | 270,066 | 274,412 |
| Other residential | 456 | 151 | — | 607 | 836 | 62,296 | 63,739 |
| Consumer: | | | | | | | |
| Consumer | 127 | 20 | — | 147 | 110 | 105,751 | 106,008 |
| Consumer other | 4,423 | 2,358 | 1 | 6,782 | — | 889,815 | 896,597 |
| Lease financing | 1,253 | 245 | — | 1,498 | 1,510 | 420,272 | 423,280 |
| Total loans | \$ 10,069 | \$ 7,445 | \$ 6 | \$ 17,520 | \$ 35,563 | \$ 5,171,718 | \$ 5,224,801 |

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The aging status of the recorded investment in loans by portfolio as of December 31, 2020 was as follows:

| (dollars in thousands) | Accruing Loans | | | | | | Nonaccrual | Current | Total |
|-------------------------------------------|---------------------|---------------------|--------------------------|----------------|-----------|--------------|--------------|---------|-------|
| | 30-59 days past due | 60-89 days past due | Past due 90 days or more | Total past due | | | | | |
| Commercial: | | | | | | | | | |
| Commercial | \$ 389 | \$ 27 | \$ — | \$ 416 | \$ 3,498 | \$ 933,468 | \$ 937,382 | | |
| Commercial other | 4,007 | 3,901 | 896 | 8,804 | 2,634 | 736,755 | 748,193 | | |
| Commercial real estate: | | | | | | | | | |
| Commercial real estate non-owner occupied | 6,684 | — | — | 6,684 | 9,332 | 855,435 | 871,451 | | |
| Commercial real estate owner occupied | 2,145 | — | — | 2,145 | 6,825 | 414,287 | 423,257 | | |
| Multi-family | 61 | — | — | 61 | 10,246 | 141,227 | 151,534 | | |
| Farmland | — | — | — | — | — | 79,731 | 79,731 | | |
| Construction and land development | 863 | — | — | 863 | 2,824 | 169,050 | 172,737 | | |
| Total commercial loans | 14,149 | 3,928 | 896 | 18,973 | 35,359 | 3,329,953 | 3,384,285 | | |
| Residential real estate: | | | | | | | | | |
| Residential first lien | 127 | 207 | — | 334 | 9,605 | 348,390 | 358,329 | | |
| Other residential | 240 | 135 | — | 375 | 2,437 | 81,739 | 84,551 | | |
| Consumer: | | | | | | | | | |
| Consumer | 325 | 57 | — | 382 | 262 | 79,998 | 80,642 | | |
| Consumer other | 4,334 | 2,874 | — | 7,208 | — | 778,252 | 785,460 | | |
| Lease financing | 4,539 | 545 | 645 | 5,729 | 1,965 | 402,370 | 410,064 | | |
| Total loans | \$ 23,714 | \$ 7,746 | \$ 1,541 | \$ 33,001 | \$ 49,628 | \$ 5,020,702 | \$ 5,103,331 | | |

Troubled Debt Restructurings

Loans modified as TDRs for commercial and commercial real estate loans generally consist of allowing commercial borrowers to defer scheduled principal payments and make interest only payments for a specified period of time at the stated interest rate of the original loan agreement or lower payments due to a modification of the loans' contractual terms. TDRs are transferred to nonaccrual status when it is probable that any remaining principal and interest payments due on the loan will not be collected in accordance with the contractual terms of the loan. TDRs that subsequently default are individually evaluated for impairment at the time of default.

The Coronavirus Aid, Relief, and Economic Security Act, as amended by Section 541 of the Consolidated Appropriations Act, provided all banks with the option to elect either or both of the following from March 1, 2020 until the earlier of January 1, 2022 or the date that is 60 days after the termination of the national emergency declared by President Trump on March 13, 2020:

- (i) to suspend the requirements under GAAP for loan modifications related to the COVID–19 pandemic that would otherwise be categorized as a TDR; and/or
- (ii) to suspend any determination of a loan modified as a result of the effects of the COVID–19 pandemic as being a TDR, including impairment for accounting purposes.

If a bank elects, which the Bank has, a suspension noted above, the suspension (i) will be effective for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019; and (ii) will not apply to any adverse impact on the credit of a borrower that is not related to the COVID–19 pandemic. The outstanding balance of modifications made as a result of COVID, that were not considered TDRs, totaled \$13.3 million and \$209.1 million at December 31, 2021 and 2020, respectively.

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The Company's TDRs are identified on a case-by-case basis in connection with the ongoing loan collection processes. The following table presents TDRs by loan portfolio as of December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | | | 2020 | | |
|-----------------------------------|-------------------------|----------------------------|------------------|-------------------------|----------------------------|------------------|
| | Accruing ⁽¹⁾ | Non-accrual ⁽²⁾ | Total | Accruing ⁽¹⁾ | Non-accrual ⁽²⁾ | Total |
| Commercial | \$ 833 | \$ 1,422 | \$ 2,255 | \$ 967 | \$ 558 | \$ 1,525 |
| Commercial real estate | 1,522 | 3,302 | 4,824 | 866 | 4,314 | 5,180 |
| Construction and land development | 37 | — | 37 | 39 | 909 | 948 |
| Residential real estate | 3,128 | 784 | 3,912 | 988 | 3,705 | 4,693 |
| Consumer | 98 | — | 98 | 41 | — | 41 |
| Lease financing | 1,394 | 241 | 1,635 | — | 38 | 38 |
| Total loans | \$ 7,012 | \$ 5,749 | \$ 12,761 | \$ 2,901 | \$ 9,524 | \$ 12,425 |

(1) These loans are still accruing interest.

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

The allowance for credit losses on TDRs totaled \$0.7 million and \$0.8 million as of December 31, 2021 and 2020, respectively. The Company had no unfunded commitments in connection with TDRs at December 31, 2021 and 2020.

The following table presents a summary of loans by portfolio that were restructured during the years ended December 31, 2021, 2020 and 2019. There were no loans modified as TDRs within the previous twelve months that subsequently defaulted during the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | Commercial Loan Portfolio | | | | Other Loan Portfolio | | | Total | |
|----------------------------------------------|---------------------------|------------------------|-----------------------------------|-------------------------|----------------------|-----------------|----------|-------|--|
| | Commercial | Commercial real estate | Construction and land development | Residential real estate | Consumer | Lease financing | | | |
| For the year ended December 31, 2021: | | | | | | | | | |
| <i>Troubled debt restructurings:</i> | | | | | | | | | |
| Number of loans | 16 | 3 | 1 | 10 | 6 | 9 | 45 | | |
| Pre-modification outstanding balance | \$ 2,294 | \$ 1,639 | \$ 49 | \$ 551 | \$ 134 | \$ 1,635 | \$ 6,302 | | |
| Post-modification outstanding balance | 2,178 | 1,539 | — | 513 | 89 | 1,635 | 5,954 | | |
| For the year ended December 31, 2020: | | | | | | | | | |
| <i>Troubled debt restructurings:</i> | | | | | | | | | |
| Number of loans | 4 | 4 | 3 | 22 | 4 | — | 37 | | |
| Pre-modification outstanding balance | \$ 989 | \$ 797 | \$ 1,010 | \$ 2,334 | \$ 34 | \$ — | \$ 5,164 | | |
| Post-modification outstanding balance | 967 | 383 | 900 | 2,172 | 33 | — | 4,455 | | |
| For the year ended December 31, 2019: | | | | | | | | | |
| <i>Troubled debt restructurings:</i> | | | | | | | | | |
| Number of loans | 1 | 3 | 2 | 25 | 5 | 1 | 37 | | |
| Pre-modification outstanding balance | \$ 249 | \$ 1,924 | \$ 221 | \$ 1,422 | \$ 26 | \$ 55 | \$ 3,897 | | |
| Post-modification outstanding balance | 249 | 1,322 | 167 | 1,322 | 25 | 55 | 3,140 | | |

Credit Quality Monitoring

The Company maintains loan policies and credit underwriting standards as part of the process of managing credit risk. These standards include making loans generally within the Company's four main regions, which include eastern, northern and southern Illinois and the St. Louis metropolitan area. In addition our specialty finance division does nationwide bridge lending for FHA and HUD developments and originates loans for multifamily, assisted and senior living and multi-use properties. Our equipment leasing business provides financing to business customers across the country.

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

The Company's consumer loan portfolio is primarily comprised of both secured and unsecured loans that are relatively small and are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer loan portfolio is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Company's Consumer Collections Group for resolution. Credit quality for the entire consumer loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

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

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

Credit Quality Indicators

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

The Company considers all loans with Risk Grades 1 - 6 as acceptable credit risks and structures and manages such relationships accordingly. Periodic financial and operating data combined with regular loan officer interactions are deemed adequate to monitor borrower performance. Loans with Risk Grades of 7 are considered "watch credits" categorized as special mention and the frequency of loan officer contact and receipt of financial data is increased to stay abreast of borrower performance. Loans with Risk Grades of 8 - 10 are considered problematic and require special care. Risk Grade 8 is categorized as substandard, 9 as substandard - nonaccrual and 10 as doubtful. Further, loans with Risk Grades of 7 - 10 are managed regularly through a number of processes, procedures and committees, including oversight by a loan administration committee comprised of executive and senior management of the Company, which includes highly structured reporting of financial and operating data, intensive loan officer intervention and strategies to exit, as well as potential management by the Company's Special Assets Group. Loans not graded in the commercial loan portfolio are monitored by aging status and payment activity.

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The following tables present the recorded investment of the commercial loan portfolio by risk category as of December 31, 2021 and 2020:

December 31, 2021

| | | | Term Loans Amortized Cost Basis by Origination Year | | | | | | | | |
|------------------------|-----------------------------------|--------------------|-----------------------------------------------------|--------------|------------|------------|------------|------------|-----------------|------------|--------------|
| | | | 2021 | 2020 | 2019 | 2018 | 2017 | Prior | Revolving loans | Total | |
| (dollars in thousands) | Commercial | Commercial | Acceptable credit quality | \$ 108,490 | \$ 78,071 | \$ 50,458 | \$ 20,045 | \$ 27,405 | \$ 35,856 | \$ 417,920 | \$ 738,245 |
| | | | Special mention | 186 | 57 | 198 | 6,154 | 2 | 316 | 1,517 | 8,430 |
| | | | Substandard | 380 | 372 | 1,934 | 1,868 | 64 | 4,322 | 8,099 | 17,039 |
| | | | Substandard – nonaccrual | 52 | — | 612 | 177 | 242 | 169 | 5,704 | 6,956 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | — | — | — | — | — | — | — | — |
| | | | Subtotal | 109,108 | 78,500 | 53,202 | 28,244 | 27,713 | 40,663 | 433,240 | 770,670 |
| | | Commercial other | Acceptable credit quality | 264,282 | 167,326 | 101,083 | 29,981 | 303 | 341 | 88,198 | 651,514 |
| | | | Special mention | — | 1,929 | 10,676 | 3,966 | — | — | 3,252 | 19,823 |
| | | | Substandard | 688 | — | 62 | 341 | — | — | 2,623 | 3,714 |
| | | | Substandard – nonaccrual | 10 | 158 | 3,894 | 384 | — | — | 21 | 4,467 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | — | — | — | — | — | — | — | — |
| | | | Subtotal | 264,980 | 169,413 | 115,715 | 34,672 | 303 | 341 | 94,094 | 679,518 |
| Commercial real estate | | Non-owner occupied | Acceptable credit quality | 441,483 | 154,379 | 134,507 | 20,524 | 55,207 | 182,465 | 5,258 | 993,823 |
| | | | Special mention | 26 | 6,341 | 14,177 | 2,296 | 711 | 2,272 | — | 25,823 |
| | | | Substandard | 6,196 | 817 | 8,825 | 20,572 | 14,857 | 22,344 | 250 | 73,861 |
| | | | Substandard – nonaccrual | 169 | 992 | 6,206 | — | 195 | 4,264 | — | 11,826 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | — | — | — | — | — | — | — | — |
| | | | Subtotal | 447,874 | 162,529 | 163,715 | 43,392 | 70,970 | 211,345 | 5,508 | 1,105,333 |
| | | Owner occupied | Acceptable credit quality | 141,084 | 69,415 | 47,187 | 35,974 | 30,583 | 98,442 | 1,886 | 424,571 |
| | | | Special mention | 150 | 24 | 187 | 161 | 13,087 | 4,540 | 32 | 18,181 |
| | | | Substandard | 4,192 | 1,127 | 10,810 | 205 | 297 | 6,466 | 305 | 23,402 |
| | | | Substandard – nonaccrual | — | 318 | 129 | 336 | 72 | 2,649 | — | 3,504 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | — | — | — | — | — | — | — | — |
| | | | Subtotal | 145,426 | 70,884 | 58,313 | 36,676 | 44,039 | 112,097 | 2,223 | 469,658 |
| | Multi-family | | Acceptable credit quality | 88,329 | 20,080 | 1,973 | 25,450 | 1,414 | 18,642 | 2,241 | 158,129 |
| | | | Special mention | — | 451 | — | — | — | — | — | 451 |
| | | | Substandard | 988 | — | — | — | — | 10,139 | — | 11,127 |
| | | | Substandard – nonaccrual | — | — | 123 | — | — | 2,045 | — | 2,168 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | — | — | — | — | — | — | — | — |
| | | | Subtotal | 89,317 | 20,531 | 2,096 | 25,450 | 1,414 | 30,826 | 2,241 | 171,875 |
| | Farmland | | Acceptable credit quality | 15,689 | 14,966 | 3,931 | 3,162 | 7,996 | 19,305 | 1,196 | 66,245 |
| | | | Special mention | — | 66 | 1,236 | 145 | 153 | 240 | — | 1,840 |
| | | | Substandard | 371 | 76 | 166 | 211 | — | 898 | — | 1,722 |
| | | | Substandard – nonaccrual | — | — | — | 105 | — | — | 50 | 155 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | — | — | — | — | — | — | — | — |
| | | | Subtotal | 16,060 | 15,108 | 5,333 | 3,623 | 8,149 | 20,443 | 1,246 | 69,962 |
| | Construction and land development | | Acceptable credit quality | 65,053 | 65,274 | 19,269 | 10,029 | 2,511 | 3,841 | 19,452 | 185,429 |
| | | | Special mention | — | — | 5,014 | — | — | 221 | — | 5,235 |
| | | | Substandard | — | 1,336 | — | — | — | — | — | 1,336 |
| | | | Substandard – nonaccrual | — | — | 43 | — | — | 40 | — | 83 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | 1,465 | 37 | — | — | — | 164 | — | 1,666 |
| | | | Subtotal | 66,518 | 66,647 | 24,326 | 10,029 | 2,511 | 4,266 | 19,452 | 193,749 |
| | Total | | Acceptable credit quality | 1,124,410 | 569,511 | 358,408 | 145,165 | 125,419 | 358,892 | 536,151 | 3,217,956 |
| | | | Special mention | 362 | 8,868 | 31,488 | 12,722 | 13,953 | 7,589 | 4,801 | 79,783 |
| | | | Substandard | 12,815 | 3,728 | 21,797 | 23,197 | 15,218 | 44,169 | 11,277 | 132,201 |
| | | | Substandard – nonaccrual | 231 | 1,468 | 11,007 | 1,002 | 509 | 9,167 | 5,775 | 29,159 |
| | | | Doubtful | — | — | — | — | — | — | — | — |
| | | | Not graded | 1,465 | 37 | — | — | — | 164 | — | 1,666 |
| | | | Total Commercial loans | \$ 1,139,283 | \$ 583,612 | \$ 422,700 | \$ 182,086 | \$ 155,099 | \$ 419,981 | \$ 558,004 | \$ 3,460,765 |

December 31, 2020

| | | | Term Loans Amortized Cost Basis by Origination Year | | | | | | | |
|-----------------------------------|-----------------------------------|---------------------------|-----------------------------------------------------|------------|------------|------------|------------|------------|-----------------|--------------|
| | | | 2020 | 2019 | 2018 | 2017 | 2016 | Prior | Revolving loans | Total |
| (dollars in thousands) | Commercial | Acceptable credit quality | \$ 117,792 | \$ 107,915 | \$ 35,649 | \$ 34,753 | \$ 22,025 | \$ 51,593 | \$ 517,929 | \$ 887,656 |
| | | Special mention | 244 | 201 | 4,897 | 3,729 | 4,968 | 881 | 7,721 | 22,641 |
| | | Substandard | 544 | 1,953 | 1,259 | 104 | 248 | 4,861 | 14,618 | 23,587 |
| | | Substandard – nonaccrual | 2 | 31 | 640 | 936 | 154 | 458 | 1,277 | 3,498 |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | — | — | — | — | — | — | — | — |
| | | Subtotal | 118,582 | 110,100 | 42,445 | 39,522 | 27,395 | 57,793 | 541,545 | 937,382 |
| Commercial other | Commercial other | Acceptable credit quality | 416,306 | 157,232 | 52,843 | 739 | 303 | 677 | 88,250 | 716,350 |
| | | Special mention | 1,871 | 10,691 | 3,810 | 31 | 79 | — | 5,315 | 21,797 |
| | | Substandard | 255 | 260 | 1,078 | 3 | 12 | — | 5,351 | 6,959 |
| | | Substandard – nonaccrual | — | 1,984 | 641 | — | 4 | — | 5 | 2,634 |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | 453 | — | — | — | — | — | — | 453 |
| | | Subtotal | 418,885 | 170,167 | 58,372 | 773 | 398 | 677 | 98,921 | 748,193 |
| Commercial real estate | Non-owner occupied | Acceptable credit quality | 168,788 | 109,602 | 63,435 | 91,763 | 97,293 | 156,958 | 5,248 | 693,087 |
| | | Special mention | 3,011 | 9,107 | 3,231 | 483 | 14,294 | 17,816 | 4,279 | 52,221 |
| | | Substandard | 7,469 | 16,306 | 13,813 | 23,169 | 16,897 | 38,907 | 250 | 116,811 |
| | | Substandard – nonaccrual | 125 | 325 | 101 | — | 3,438 | 5,343 | — | 9,332 |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | — | — | — | — | — | — | — | — |
| | | Subtotal | 179,393 | 135,340 | 80,580 | 115,415 | 131,922 | 219,024 | 9,777 | 871,451 |
| Commercial real estate | Owner occupied | Acceptable credit quality | 68,688 | 55,502 | 38,471 | 55,526 | 63,105 | 91,986 | 4,066 | 377,344 |
| | | Special mention | 1,882 | 3,578 | 225 | 4,142 | 1,038 | 7,289 | — | 18,154 |
| | | Substandard | 4,078 | 468 | 1,023 | 760 | 5,861 | 8,430 | 314 | 20,934 |
| | | Substandard – nonaccrual | 373 | 200 | 170 | 241 | — | 5,441 | 400 | 6,825 |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | — | — | — | — | — | — | — | — |
| | | Subtotal | 75,021 | 59,748 | 39,889 | 60,669 | 70,004 | 113,146 | 4,780 | 423,257 |
| Residential real estate | Multi-family | Acceptable credit quality | 12,865 | 6,921 | 19,204 | 32,934 | 10,674 | 24,375 | 1,281 | 108,254 |
| | | Special mention | 465 | — | 8,442 | — | — | 1,323 | — | 10,230 |
| | | Substandard | — | 10,945 | 1,518 | — | 10,266 | 75 | — | 22,804 |
| | | Substandard – nonaccrual | — | — | — | — | 7,804 | 2,442 | — | 10,246 |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | — | — | — | — | — | — | — | — |
| | | Subtotal | 13,330 | 17,866 | 29,164 | 32,934 | 28,744 | 28,215 | 1,281 | 151,534 |
| Farmland | Farmland | Acceptable credit quality | 18,556 | 6,846 | 3,873 | 8,803 | 6,013 | 23,921 | 1,814 | 69,826 |
| | | Special mention | 274 | 1,387 | 180 | 38 | 298 | 784 | — | 2,961 |
| | | Substandard | 2,241 | 307 | 802 | 127 | 877 | 2,435 | 155 | 6,944 |
| | | Substandard – nonaccrual | — | — | — | — | — | — | — | — |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | — | — | — | — | — | — | — | — |
| | | Subtotal | 21,071 | 8,540 | 4,855 | 8,968 | 7,188 | 27,140 | 1,969 | 79,731 |
| Construction and land development | Construction and land development | Acceptable credit quality | 36,488 | 83,440 | 11,625 | 3,554 | 2,506 | 4,263 | 15,941 | 157,817 |
| | | Special mention | — | — | 454 | — | — | — | — | 454 |
| | | Substandard | 1,386 | 8,875 | — | — | — | 914 | — | 11,175 |
| | | Substandard – nonaccrual | — | 242 | — | — | 152 | 2,430 | — | 2,824 |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | 467 | — | — | — | — | — | — | 467 |
| | | Subtotal | 38,341 | 92,557 | 12,079 | 3,554 | 2,658 | 7,607 | 15,941 | 172,737 |
| Total | Total | Acceptable credit quality | 839,483 | 527,458 | 225,100 | 228,072 | 201,919 | 353,773 | 634,529 | 3,010,334 |
| | | Special mention | 7,747 | 24,964 | 21,239 | 8,423 | 20,677 | 28,093 | 17,315 | 128,458 |
| | | Substandard | 15,973 | 39,114 | 19,493 | 24,163 | 34,161 | 55,622 | 20,688 | 209,214 |
| | | Substandard – nonaccrual | 500 | 2,782 | 1,552 | 1,177 | 11,552 | 16,114 | 1,682 | 35,359 |
| | | Doubtful | — | — | — | — | — | — | — | — |
| | | Not graded | 920 | — | — | — | — | — | — | 920 |
| Total Commercial loans | | | \$ 864,623 | \$ 594,318 | \$ 267,384 | \$ 261,835 | \$ 268,309 | \$ 453,602 | \$ 674,214 | \$ 3,384,285 |

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The Company evaluates the credit quality of its other loan portfolio, which includes residential real estate, consumer and lease financing loans, based primarily on the aging status of the loan and payment activity. Accordingly, loans on nonaccrual status, loans past due 90 days or more and still accruing interest, and loans modified under troubled debt restructurings are considered to be nonperforming for purposes of credit quality evaluation. The following tables present the recorded investment of our other loan portfolio based on the credit risk profile of loans that are performing and loans that are nonperforming at December 31, 2021 and 2020:

| | | December 31, 2021 | | | | | | | | | |
|-------------------------|------------------------|-----------------------------------------------------|-------------------|-------------------|-------------------|------------------|------------------|-------------------|------------------|---------------------|--|
| | | Term Loans Amortized Cost Basis by Origination Year | | | | | | Revolving Loans | | | |
| Residential real estate | Residential first lien | | | 2021 | 2020 | 2019 | 2018 | 2017 | Prior | Total | |
| | | Performing | \$ 38,508 | \$ 31,920 | \$ 24,311 | \$ 30,842 | \$ 48,276 | \$ 93,462 | \$ 888 | \$ 268,207 | |
| | | Nonperforming | — | 108 | 173 | 780 | 764 | 4,380 | — | 6,205 | |
| | | Subtotal | <u>38,508</u> | <u>32,028</u> | <u>24,484</u> | <u>31,622</u> | <u>49,040</u> | <u>97,842</u> | <u>888</u> | <u>274,412</u> | |
| | Other residential | Performing | 888 | 679 | 1,520 | 1,950 | 1,211 | 1,559 | 54,225 | 62,032 | |
| | | Nonperforming | — | — | 10 | 16 | 128 | 100 | 1,453 | 1,707 | |
| | | Subtotal | <u>888</u> | <u>679</u> | <u>1,530</u> | <u>1,966</u> | <u>1,339</u> | <u>1,659</u> | <u>55,678</u> | <u>63,739</u> | |
| Consumer | Consumer | Performing | 65,915 | 14,955 | 7,874 | 8,728 | 3,025 | 2,582 | 2,721 | 105,800 | |
| | | Nonperforming | 89 | 5 | 3 | 14 | 24 | 71 | 2 | 208 | |
| | | Subtotal | <u>66,004</u> | <u>14,960</u> | <u>7,877</u> | <u>8,742</u> | <u>3,049</u> | <u>2,653</u> | <u>2,723</u> | <u>106,008</u> | |
| | Consumer other | Performing | 474,385 | 323,437 | 63,463 | 12,635 | 3,888 | 5,447 | 13,341 | 896,596 | |
| | | Nonperforming | — | — | — | — | — | — | 1 | 1 | |
| | | Subtotal | <u>474,385</u> | <u>323,437</u> | <u>63,463</u> | <u>12,635</u> | <u>3,888</u> | <u>5,447</u> | <u>13,342</u> | <u>896,597</u> | |
| Leases financing | | Performing | 154,803 | 124,575 | 86,402 | 43,536 | 9,077 | 1,983 | — | 420,376 | |
| | | Nonperforming | — | 757 | 1,001 | 1,012 | 95 | 39 | — | 2,904 | |
| | | Subtotal | <u>154,803</u> | <u>125,332</u> | <u>87,403</u> | <u>44,548</u> | <u>9,172</u> | <u>2,022</u> | <u>—</u> | <u>423,280</u> | |
| Total | | Performing | 734,499 | 495,566 | 183,570 | 97,691 | 65,477 | 105,033 | 71,175 | 1,753,011 | |
| Total other loans | | Nonperforming | 89 | 870 | 1,187 | 1,822 | 1,011 | 4,590 | 1,456 | 11,025 | |
| | | Subtotal | <u>\$ 734,588</u> | <u>\$ 496,436</u> | <u>\$ 184,757</u> | <u>\$ 99,513</u> | <u>\$ 66,488</u> | <u>\$ 109,623</u> | <u>\$ 72,631</u> | <u>\$ 1,764,036</u> | |

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| | | December 31, 2020 | | | | | | | | |
|-------------------------|------------------------|-----------------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|----------------------------------------------|----------------------------------------------|--|
| | | Term Loans Amortized Cost Basis by Origination Year | | | | | | Revolving loans | Total | |
| | | 2020 | 2019 | 2018 | 2017 | 2016 | Prior | | | |
| Residential real estate | Residential first lien | Performing | \$ 32,322 | \$ 27,071 | \$ 49,039 | \$ 99,658 | \$ 81,525 | \$ 58,107 | \$ 348,127 | |
| | | Nonperforming | — | 196 | 1,074 | 933 | 1,030 | 6,969 | 10,202 | |
| | | Subtotal | 32,322 | 27,267 | 50,113 | 100,591 | 82,555 | 65,076 | 358,329 | |
| Other residential | Other residential | Performing | 975 | 2,430 | 3,281 | 2,091 | 1,348 | 1,825 | 69,773 | |
| | | Nonperforming | — | 13 | 21 | 146 | 7 | 165 | 2,476 | |
| | | Subtotal | 975 | 2,443 | 3,302 | 2,237 | 1,355 | 1,990 | 72,249 | |
| Consumer | Consumer | Performing | 28,449 | 14,084 | 16,692 | 8,737 | 5,067 | 3,834 | 3,476 | |
| | | Nonperforming | 31 | 6 | 57 | 81 | 64 | 63 | 1 | |
| | | Subtotal | 28,480 | 14,090 | 16,749 | 8,818 | 5,131 | 3,897 | 3,477 | |
| Consumer other | Consumer other | Performing | 614,764 | 117,054 | 21,394 | 6,514 | 6,096 | 2,480 | 17,158 | |
| | | Nonperforming | — | — | — | — | — | — | — | |
| | | Subtotal | 614,764 | 117,054 | 21,394 | 6,514 | 6,096 | 2,480 | 17,158 | |
| Leases financing | Leases financing | Performing | 177,068 | 125,611 | 70,059 | 21,047 | 12,410 | 1,259 | — | |
| | | Nonperforming | 468 | 192 | 1,080 | 600 | 207 | 63 | — | |
| | | Subtotal | 177,536 | 125,803 | 71,139 | 21,647 | 12,617 | 1,322 | — | |
| Total | | Performing | 853,578 | 286,250 | 160,465 | 138,047 | 106,446 | 67,505 | 90,812 | |
| | | Nonperforming | 499 | 407 | 2,232 | 1,760 | 1,308 | 7,260 | 2,477 | |
| Total other loans | | | \$ 854,077 | \$ 286,657 | \$ 162,697 | \$ 139,807 | \$ 107,754 | \$ 74,765 | \$ 93,289 | |
| | | | <u>\$ 854,077</u> | <u>\$ 286,657</u> | <u>\$ 162,697</u> | <u>\$ 139,807</u> | <u>\$ 107,754</u> | <u>\$ 74,765</u> | <u>\$ 93,289</u> | |
| | | | <u><u>\$ 854,077</u></u> | <u><u>\$ 286,657</u></u> | <u><u>\$ 162,697</u></u> | <u><u>\$ 139,807</u></u> | <u><u>\$ 107,754</u></u> | <u><u>\$ 74,765</u></u> | <u><u>\$ 93,289</u></u> | |
| | | | <u><u><u>\$ 854,077</u></u></u> | <u><u><u>\$ 286,657</u></u></u> | <u><u><u>\$ 162,697</u></u></u> | <u><u><u>\$ 139,807</u></u></u> | <u><u><u>\$ 107,754</u></u></u> | <u><u><u>\$ 74,765</u></u></u> | <u><u><u>\$ 93,289</u></u></u> | |
| | | | <u><u><u><u>\$ 854,077</u></u></u></u> | <u><u><u><u>\$ 286,657</u></u></u></u> | <u><u><u><u>\$ 162,697</u></u></u></u> | <u><u><u><u>\$ 139,807</u></u></u></u> | <u><u><u><u>\$ 107,754</u></u></u></u> | <u><u><u><u>\$ 74,765</u></u></u></u> | <u><u><u><u>\$ 93,289</u></u></u></u> | |
| | | | <u><u><u><u><u>\$ 854,077</u></u></u></u></u> | <u><u><u><u><u>\$ 286,657</u></u></u></u></u> | <u><u><u><u><u>\$ 162,697</u></u></u></u></u> | <u><u><u><u><u>\$ 139,807</u></u></u></u></u> | <u><u><u><u><u>\$ 107,754</u></u></u></u></u> | <u><u><u><u><u>\$ 74,765</u></u></u></u></u> | <u><u><u><u><u>\$ 93,289</u></u></u></u></u> | |

NOTE 6 – PREMISES AND EQUIPMENT, NET

A summary of premises and equipment at December 31, 2021 and 2020 is as follows:

| (dollars in thousands) | 2021 | 2020 |
|-----------------------------|-----------|-----------|
| Land | \$ 15,696 | \$ 16,158 |
| Buildings and improvements | 67,143 | 65,932 |
| Furniture and equipment | 33,545 | 33,202 |
| Total | 116,384 | 115,292 |
| Accumulated depreciation | (45,592) | (41,168) |
| Premises and equipment, net | \$ 70,792 | \$ 74,124 |

Depreciation expense for the years ended December 31, 2021, 2020 and 2019 was \$5.5 million, \$6.9 million, and \$6.6 million, respectively.

The Company closed 13 branches, or 20% of its branch network, and vacated approximately 23,000 square feet of corporate office space between September 3, 2020 and December 31, 2020, recording \$12.7 million of asset impairment on existing banking facilities, including \$2.4 million of asset impairment on right-of-use assets, and \$0.8 million in other related charges, all of which was recognized in other expense in the consolidated statements of income

In 2019, the Company closed one facility and consolidated two additional facilities as a result of the acquisition of HomeStar, as further discussed in Note 2 to the consolidated financial statements. In addition, the Company planned to consolidate three other existing facilities in other areas of its footprint, one of which closed in 2019 and the remaining two facilities closed in January of 2020. Consequently, during the year ended December 31, 2019, the Company recorded

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\$3.2 million of asset impairment on banking facilities to be closed, which was recognized in other expense in the consolidated statements of income.

Assets held for sale were \$2.3 million and \$4.2 million at December 31, 2021 and 2020, respectively, which are included in other assets in our consolidated balance sheets.

NOTE 7 – LEASES

The Company had operating lease right-of-use assets of \$8.4 million and \$9.2 million as of December 31, 2021 and 2020, respectively, and operating lease liabilities of \$10.7 million and \$12.0 million at the same dates, respectively.

As a result of the branch and corporate office reductions in 2020, discussed in Note 6, the Company recorded \$2.4 million of asset impairment on existing right-of-use assets, which was recognized in other expense in the consolidated statements of income.

The operating leases, primarily for banking offices and operating facilities, have remaining lease terms of 6 months to 11 years, some of which may include options to extend the lease terms for up to an additional 10 years. The options to extend are included if they are reasonably certain to be exercised.

Information related to operating leases for the years ended December 31, 2021 and 2020 was as follows:

| (dollars in thousands) | 2021 | 2020 |
|--------------------------------------------------------------------|------------|------------|
| Operating lease cost | \$ 2,080 | \$ 2,943 |
| Operating cash flows related to leases | 2,566 | 3,280 |
| Right-of-use assets obtained in exchange for lease obligations | 1,118 | 1,616 |
| Right-of-use assets derecognized due to terminations or impairment | (210) | (4,467) |
| Weighted average remaining lease term | 7.58 years | 8.10 years |
| Weighted average discount rate | 2.85 % | 2.90 % |

Net rent expense under operating leases, included in occupancy and equipment expense, was \$1.4 million, \$2.3 million and \$2.8 million for the years ended December 31, 2021, 2020 and 2019, respectively.

The projected minimum rental payments under the terms of the leases as of December 31, 2021 are as follows:

| (dollars in thousands) | Amount |
|-------------------------------------|-----------|
| Year ending December 31, | |
| 2022 | \$ 2,180 |
| 2023 | 2,094 |
| 2024 | 1,799 |
| 2025 | 894 |
| 2026 | 763 |
| Thereafter | 4,251 |
| Total future minimum lease payments | 11,981 |
| Less imputed interest | (1,267) |
| Total operating lease liabilities | \$ 10,714 |

NOTE 8 – LOAN SERVICING RIGHTS

A summary of loan servicing rights at December 31, 2021 and 2020 is as follows:

| (dollars in thousands) | 2021 | | 2020 | |
|----------------------------|----------------------------|-------------------------|----------------------------|-------------------------|
| | Serviced Loans | Carrying Value | Serviced Loans | Carrying Value |
| Commercial FHA | \$ 2,650,531 | \$ 27,386 | \$ 3,499,258 | \$ 38,322 |
| SBA | 50,043 | 774 | 49,223 | 954 |
| Residential ⁽¹⁾ | 302,618 | 705 | 382,302 | 878 |
| Total | <u><u>\$ 3,003,192</u></u> | <u><u>\$ 28,865</u></u> | <u><u>\$ 3,930,783</u></u> | <u><u>\$ 40,154</u></u> |

- (1) At December 31, 2020, residential mortgage servicing rights were classified as held for sale and carried at fair value less estimated costs to sell. These were reclassified to loan servicing rights effective December 31, 2021.

Commercial FHA Mortgage Loan Servicing

Changes in our commercial FHA loan servicing rights for the years ended December 31, 2021, 2020 and 2019 are summarized as follows:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|-------------------------------------------|------------------|------------------|------------------|
| Loan servicing rights: | | | |
| Balance, beginning of period | \$ 38,322 | \$ 57,637 | \$ 56,252 |
| Originated servicing | — | 1,128 | 4,124 |
| Amortization | (2,965) | (3,162) | (2,739) |
| Refinancing fee received from third party | (439) | — | — |
| Permanent impairment | (7,532) | (17,281) | — |
| Balance, end of period | <u>27,386</u> | <u>38,322</u> | <u>57,637</u> |
| Valuation allowances: | | | |
| Balance, beginning of period | — | 4,944 | 2,805 |
| Additions | — | 12,337 | 2,698 |
| Reductions | — | (17,281) | (559) |
| Balance, end of period | <u>—</u> | <u>—</u> | <u>4,944</u> |
| Loan servicing rights, net | <u>\$ 27,386</u> | <u>\$ 38,322</u> | <u>\$ 52,693</u> |
| Fair value: | | | |
| At beginning of period | <u>\$ 38,322</u> | <u>\$ 52,693</u> | <u>\$ 53,447</u> |
| At end of period | <u>\$ 28,368</u> | <u>\$ 38,322</u> | <u>\$ 52,693</u> |

The fair value of commercial FHA loan servicing rights is determined using key assumptions, representing both general economic and other published information, including the assumed earnings rates related to escrow and replacement reserves, and the weighted average characteristics of the commercial portfolio, including the prepayment rate and discount rate. The prepayment rate considers many factors as appropriate, including lockouts, balloons, prepayment penalties, interest rate ranges, delinquencies and geographic location. The discount rate is based on an average pre-tax internal rate of return utilized by market participants in pricing the servicing portfolio. Significant increases or decreases in any one of these assumptions would result in a significantly lower or higher fair value measurement. The weighted average prepayment rate was 8.24% and 8.18% at December 31, 2021 and 2020, respectively, while the weighted average discount rate was 11.87% and 11.48% for the same periods, respectively.

NOTE 9 – GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2021 and 2020, goodwill totaled \$161.9 million. Goodwill is tested for impairment at least annually or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company performed its most recent annual goodwill impairment test as of August 31, 2021 and concluded that no impairment existed as of that date. No events or circumstances since the August 31, 2021 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists, for either of the Company's segments.

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The carrying amount of goodwill by segment at December 31, 2021 and 2020 is summarized as follows:

| (dollars in thousands) | 2021 | 2020 |
|------------------------|-------------------|-------------------|
| Banking | \$ 157,158 | \$ 157,158 |
| Wealth management | 4,746 | 4,746 |
| Total goodwill | <u>\$ 161,904</u> | <u>\$ 161,904</u> |

The Company's intangible assets consist of core deposit and customer relationship intangibles. Intangible assets are assessed for impairment at least annually or more frequently if events and circumstances exists that indicate that an intangible impairment test should be performed. The Company has not identified any events or changes in circumstances that would indicate a change in the recoverability of the carrying value of intangible assets and, therefore, no impairment was recognized during 2021, 2020 or 2019.

The Company's intangible assets as of December 31, 2021 and 2020 are summarized as follows:

| (dollars in thousands) | 2021 | | | 2020 | | |
|-----------------------------------|-----------------------|--------------------------|------------------|-----------------------|--------------------------|------------------|
| | Gross Carrying Amount | Accumulated Amortization | Total | Gross Carrying Amount | Accumulated Amortization | Total |
| Core deposit intangibles | \$ 57,012 | \$ (40,603) | \$ 16,409 | \$ 57,012 | \$ (36,005) | \$ 21,007 |
| Customer relationship intangibles | 15,918 | (7,953) | 7,965 | 14,071 | (6,696) | 7,375 |
| Total intangible assets | <u>\$ 72,930</u> | <u>\$ (48,556)</u> | <u>\$ 24,374</u> | <u>\$ 71,083</u> | <u>\$ (42,701)</u> | <u>\$ 28,382</u> |

In conjunction with the acquisition of ATG Trust, the Company recorded \$1.8 million of customer relationship intangibles, which are being amortized on a straight line basis over an estimated useful life of 6 years.

Amortization of intangible assets was \$5.9 million, \$6.5 million and \$7.1 million for the years ended December 31, 2021, 2020 and 2019, respectively.

Estimated amortization expense for future years is as follows:

| (dollars in thousands) | Amount |
|--------------------------|------------------|
| Year ending December 31, | |
| 2022 | \$ 5,208 |
| 2023 | 4,433 |
| 2024 | 3,717 |
| 2025 | 2,966 |
| 2026 | 2,450 |
| Thereafter | 5,600 |
| Total | <u>\$ 24,374</u> |

NOTE 10 – DERIVATIVE INSTRUMENTS

As part of the Company's overall management of interest rate sensitivity, the Company utilizes derivative instruments to minimize significant, unanticipated earnings fluctuations caused by interest rate volatility, including interest rate lock commitments, forward commitments to sell mortgage-backed securities, cash flow hedges and interest rate swap contracts.

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

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

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The following tables summarize the interest rate lock commitments and forward commitments to sell mortgage-backed securities held by the Company, their notional amount and estimated fair values at December 31, 2021 and 2020:

| (dollars in thousands) | Notional Amount | | Fair Value Gain | |
|----------------------------------------------------------------|-------------------|-------------------|-----------------|-----------------|
| | 2021 | 2020 | 2021 | 2020 |
| Derivative Instruments (included in other assets): | | | | |
| Interest rate lock commitments | \$ 66,216 | \$ 136,227 | \$ 410 | \$ 2,217 |
| Forward commitments to sell mortgage-backed securities | 60,427 | 218,126 | — | — |
| Total | <u>\$ 126,643</u> | <u>\$ 354,353</u> | <u>\$ 410</u> | <u>\$ 2,217</u> |
| | | | | |
| (dollars in thousands) | Notional Amounts | | Fair Value Loss | |
| | 2021 | 2020 | 2021 | 2020 |
| Derivative Instruments (included in other liabilities): | | | | |
| Forward commitments to sell mortgage-backed securities | \$ 18,362 | \$ 33,240 | \$ 19 | \$ 309 |

During the years ended December 31, 2021, 2020 and 2019, the Company recognized net losses of \$1.5 million, \$1.4 million and \$1.1 million, respectively, on derivative instruments in commercial FHA revenue and residential mortgage banking revenue in the consolidated statements of income.

Cash Flow Hedges

In 2020, the Company entered into interest rate swap agreements, which qualify as cash flow hedges, to manage the risk of changes in future cash flows due to interest rate fluctuations. The following table summarizes the Company's receive-fixed, pay-variable interest rate swaps on certain FHLB advances at December 31, 2020:

| (dollars in thousands) | 2020 |
|---------------------------------|------------|
| Notional Amount | \$ 100,000 |
| Average remaining life in years | 5.3 |
| Weighted average pay rate | 0.57 % |
| Weighted average receive rate | 0.22 % |

During 2021, the Company terminated the above interest rate swap agreements in conjunction with the repayment of FHLB advances of \$100.0 million. A net gain of \$2.2 million was recognized in other income in the consolidated statements of income.

In addition, the Company has entered into \$140.0 million notional amount of future starting pay-fixed, receive-variable interest rate swaps on certain FHLB or other fixed-rate advances. These swaps are effective beginning in April 2023. The Company pays or receives the net interest amount quarterly based on the respective hedge agreement and includes the amount as part of FHLB advances interest expense on the consolidated statements of income.

Quarterly, the effectiveness evaluation is based on the fluctuation of the interest the Company pays to the FHLB for the debt as compared to the three-month LIBOR interest received from the counterparty. At December 31, 2021, the \$5.1 million fair value of the cash flow hedges was included in other assets in the consolidated balance sheets. The tax effected amount of \$3.7 million was included in accumulated other comprehensive income. There were no amounts recorded in the consolidated statements of income for the year ended December 31, 2021, related to ineffectiveness.

Interest Rate Swap Contracts

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

The notional amounts of these customer derivative instruments and the offsetting counterparty derivative instruments were \$7.9 million and \$8.5 million at December 31, 2021 and 2020, respectively. The fair value of the customer derivative

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instruments and the offsetting counterparty derivative instruments was \$0.4 million and \$0.8 million at December 31, 2021 and 2020, respectively, which are included in other assets and other liabilities, respectively, on the consolidated balance sheets.

NOTE 11 – DEPOSITS

The following table summarizes the classification of deposits at December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | 2020 |
|----------------------------|---------------------|---------------------|
| Noninterest-bearing demand | \$ 2,245,701 | \$ 1,469,579 |
| Interest-bearing: | | |
| Checking | 1,663,021 | 1,568,888 |
| Money market | 869,067 | 785,871 |
| Savings | 679,115 | 597,966 |
| Time | 653,744 | 678,712 |
| Total deposits | <u>\$ 6,110,648</u> | <u>\$ 5,101,016</u> |

Included in time deposits are uninsured time certificates of \$143.5 million and \$88.3 million as of December 31, 2021 and 2020, respectively.

As of December 31, 2021, the scheduled maturities of time deposits were as follows:

| (dollars in thousands) | Amount |
|---------------------------------|-------------------|
| Year Ending December 31, | |
| 2022 | \$ 377,823 |
| 2023 | 134,092 |
| 2024 | 82,430 |
| 2025 | 19,778 |
| 2026 | 39,597 |
| Thereafter | 24 |
| Total | <u>\$ 653,744</u> |

NOTE 12 – SHORT-TERM BORROWINGS

The following table presents the distribution of short-term borrowings and related weighted average interest rates for each of the years ended December 31, 2021 and 2020:

| (dollars in thousands) | Repurchase Agreements | |
|---------------------------------------------|-----------------------|-----------|
| | 2021 | 2020 |
| Outstanding at period-end | \$ 76,803 | \$ 68,957 |
| Average amount outstanding | 68,986 | 60,306 |
| Maximum amount outstanding at any month end | 77,497 | 77,136 |
| Weighted average interest rate: | | |
| During period | 0.12 % | 0.30 % |
| End of period | 0.13 % | 0.12 % |

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction, which represents the amount of the Bank's obligation. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. Investment securities with a carrying amount of \$78.3 million and \$76.5 million at December 31, 2021 and 2020, respectively, were pledged for securities sold under agreements to repurchase.

The Company had available lines of credit of \$55.9 million and \$54.4 million at December 31, 2021 and 2020, respectively, from the Federal Reserve Discount Window. The lines are collateralized by a collateral agreement with respect to

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a pool of commercial real estate loans totaling \$64.8 million and \$68.1 million at December 31, 2021 and 2020, respectively. There were no outstanding borrowings at December 31, 2021 and 2020.

At December 31, 2021, the Company had federal funds lines of credit totaling \$45.0 million. These lines of credit were unused at December 31, 2021.

NOTE 13 – FHLB ADVANCES AND OTHER BORROWINGS

The following table summarizes our FHLB advances and other borrowings at December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | 2020 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| Midland States Bancorp, Inc. | | |
| Series G redeemable preferred stock – 171 and 171 shares at December 31, 2021 and 2020, respectively at \$1,000 per share | \$ 171 | \$ 171 |
| Midland States Bank | | |
| FHLB advances – fixed rate, fixed term at rates averaging 0.24% at December 31, 2020 | — | 304,000 |
| FHLB advances – putable fixed rate at rates averaging 1.48% and 2.01% at December 31, 2021 and 2020, respectively – maturing through February 2030 with call provisions through February 2022 | 210,000 | 475,000 |
| FHLB advances - SOFR floater at rates averaging 1.67% at December 31, 2021 - maturing in October 2023 | 100,000 | — |
| Total FHLB advances and other borrowings | <u>\$ 310,171</u> | <u>\$ 779,171</u> |

The Company's advances from the FHLB are collateralized by a blanket collateral agreement of qualifying mortgage and home equity line of credit loans and certain commercial real estate loans totaling \$2.10 billion and \$1.86 billion at December 31, 2021 and 2020, respectively.

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

| (dollars in thousands) | Amount |
|---------------------------------|-------------------|
| Year Ending December 31, | |
| 2022 | \$ — |
| 2023 | 140,000 |
| 2024 | 70,000 |
| 2025 | — |
| 2026 | — |
| Thereafter | <u>100,171</u> |
| Total | <u>\$ 310,171</u> |

NOTE 14 – SUBORDINATED DEBT

The following table summarizes the Company's subordinated debt at December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | 2020 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| Subordinated debt issued June 2015 – variable interest rate equivalent to three month LIBOR plus 4.35%, which was 4.59% at December 31, 2020 | \$ — | \$ 31,075 |
| Subordinated debt issued June 2015 – fixed interest rate of 6.50%, \$550 – maturing June 18, 2025 | 546 | 545 |
| Subordinated debt issued October 2017 - fixed interest rate of 6.25% through October 2022 and a variable interest rate equivalent to three month LIBOR plus 4.23% thereafter, \$40,000 – maturing October 15, 2027 | 39,626 | 39,561 |
| Subordinated debt issued September 2019 – fixed interest rate of 5.00% through September 2024 and a variable interest rate equivalent to three month SOFR plus 3.61% thereafter, \$72,750 – maturing September 30, 2029 | 72,042 | 71,785 |
| Subordinated debt issued September 2019 – fixed interest rate of 5.50% through September 2029 and a variable interest rate equivalent to three month SOFR plus 4.05% thereafter, \$27,250 – maturing September 30, 2034 | 26,877 | 26,829 |
| Total subordinated debt | <u>\$ 139,091</u> | <u>\$ 169,795</u> |

In June 2015, the Company issued, through a private placement, \$55.3 million aggregate principal amount of subordinated debentures. The transaction was structured in two tranches: (1) \$40.3 million, maturing on June 18, 2025 with a redemption option on or after June 18, 2020, with a fixed rate of interest of 6.00% for the first five years, payable semiannually in arrears beginning December 18, 2015, and a floating rate of interest equivalent to the three-month LIBOR plus 435 basis points thereafter, payable quarterly beginning on September 18, 2020; and (2) \$15.0 million, maturing on June 18, 2025, with a fixed rate of interest of 6.50%, payable semiannually in arrears beginning December 18, 2015. The value of the subordinated debentures was reduced by \$0.9 million of debt issuance costs, which are being amortized on a straight line basis through the earlier of the redemption option or maturity date of the subordinated debentures. Of the \$40.3 million subordinated debentures the Company repurchased \$2.0 million during the fourth quarter of 2019, \$7.3 million during the first quarter of 2020 and the remaining \$31.1 million during the second quarter of 2021. The Company recognized losses of \$1.4 million in the fourth quarter of 2019 and \$0.2 million in the first quarter of 2020, which included the premium paid for the repurchase and the remaining unamortized debt issuance costs on such repurchases. No gain or loss was recognized on the 2021 repurchase. The Company also repurchased \$14.5 million of the \$15.0 million subordinated debentures during the fourth quarter of 2019 and recognized a loss of \$0.4 million which included the premium paid for the repurchase and the remaining unamortized debt issuance costs on such repurchases. These losses were recognized in other noninterest expense in the consolidated statements of income.

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

On September 20, 2019, the Company issued, through a private placement, \$100.0 million aggregate principal amount of subordinated debentures. The transaction was structured in two tranches: (1) \$72.8 million, maturing on September 30, 2029 with a redemption option on or after September 30, 2024, with a fixed rate of interest of 5.00% for the first five years, payable semiannually in arrears beginning March 30, 2020, and a floating rate of interest equivalent to the three-month Secured Overnight Financing Rate (“SOFR”) plus 361.0 basis points thereafter, payable quarterly in arrears beginning on December 30, 2024; and (2) \$27.3 million, maturing on September 30, 2034 with a redemption option on or after September 30, 2029, with a fixed rate of interest of 5.50% for the first ten years, payable semiannually in arrears beginning March 30, 2020, and a floating rate of interest equivalent to the three-month SOFR plus 404.5 basis points thereafter, payable quarterly in arrears beginning on December 30, 2029. The value of the subordinated debentures was reduced by \$1.6 million of debt issuance costs, which are being amortized on a straight line basis through the redemption option of the subordinated debentures.

All of the subordinated debentures mentioned above may be included in Tier 2 capital (with certain limitations applicable) under current regulatory guidelines and interpretations.

NOTE 15 – TRUST PREFERRED DEBENTURES

The following table summarizes the Company's trust preferred debentures at December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | 2020 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| Midland States Preferred Securities Trust – variable interest rate equal to LIBOR plus 2.75%, which was 2.87% and 2.96% at December 31, 2021 and 2020, respectively – \$10,310 maturing April 23, 2034 | \$ 10,279 | \$ 10,276 |
| Grant Park Statutory Trust I – variable interest rate equal to LIBOR plus 2.85%, which was 2.98% and 3.06%, at December 31, 2021 and 2020, respectively – \$3,093 maturing January 23, 2034 | 2,363 | 2,314 |
| Love Savings/Heartland Capital Trust III – variable interest rate equal to LIBOR plus 1.75%, which was 1.95% and 1.97% at December 31, 2021 and 2020, respectively – \$20,619 maturing December 31, 2036 | 14,647 | 14,442 |
| Love Savings/Heartland Capital Trust IV – variable interest rate equal to LIBOR plus 1.47%, which was 1.65% and 1.70% at December 31, 2021 and 2020, respectively – \$20,619 maturing September 6, 2037 | 13,830 | 13,621 |
| Centrue Statutory Trust II - variable interest rate equal to LIBOR plus 2.65%, which was 2.87% and 2.88% at December 31, 2021 and 2020, respectively - \$10,310 maturing June 17, 2034 | 8,255 | 8,161 |
| Total trust preferred debentures | <u>\$ 49,374</u> | <u>\$ 48,814</u> |

On March 26, 2004, the Company formed Midland States Preferred Securities Trust (“Midland Trust”), a statutory trust under the Delaware Statutory Trust Act. Midland Trust issued a pool of \$10.0 million of floating rate cumulative trust preferred securities with a liquidation amount of \$1,000 per security. The Company issued \$10.3 million of subordinated debentures to the Midland Trust in exchange for ownership of all the common securities of the Midland Trust. The Company is

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not considered the primary beneficiary of the Midland Trust; therefore, the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures, net of unamortized debt issuance costs, are shown as a liability. The Company's investment in the common stock of the trust was \$0.3 million and is included in other assets.

In conjunction with the acquisition of Grant Park Bancshares, Inc. ("Grant Park") on June 5, 2013, the Company assumed \$3.1 million of subordinated debentures that were recorded at a fair value of \$1.8 million at the time of acquisition. On December 19, 2003, Grant Park Statutory Trust I ("Grant Park Trust") issued 3,000 shares of preferred securities with a liquidation amount of \$1,000 per security. Grant Park issued \$3.1 million of subordinated debentures to the Grant Park Trust in exchange for ownership of all the common securities of the trust. The Company is not considered the primary beneficiary of the Grant Park Trust; therefore, the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures, net of unamortized purchase discount, are shown as a liability. The Company's investment in the common stock of the trust was \$0.1 million and is included in other assets.

In conjunction with the acquisition of Love Savings Holding Company ("LSHC") on December 31, 2014, the Company assumed \$41.2 million of subordinated debentures that were recorded at a fair value of \$26.1 million at the time of acquisition. On November 30, 2006, Love Savings/Heartland Capital Trust III ("LSHC Trust III") issued 20,000 shares of capital securities with a liquidation amount of \$1,000 per security. LSHC issued \$20.6 million of subordinated debentures to LSHC Trust III in exchange for ownership of all the common securities of the trust. On June 6, 2007, Love Savings/Heartland Capital Trust IV ("LSHC Trust IV") issued 20,000 shares of capital securities with a liquidation amount of \$1,000 per security. LSHC issued \$20.6 million of subordinated debentures to LSHC Trust IV in exchange for ownership of all the common securities of the trust. The Company is not considered the primary beneficiary of LSHC Trust III or LSHC Trust IV; therefore, the trusts are not consolidated in the Company's financial statements, but rather the subordinated debentures, net of unamortized purchase discount, are shown as a liability. The Company's investment in the common stock of the trusts was \$1.2 million and is included in other assets.

In conjunction with the acquisition of Centrue on June 9, 2017, the Company assumed \$10.3 million of subordinated debentures that were recorded at a fair value of \$7.6 million at the time of acquisition. In April 2004, Centrue Statutory Trust II ("Centrue Trust II") issued 10,000 shares of trust preferred securities with a liquidation amount of \$1,000 per preferred security. Centrue issued \$10.3 million of subordinated debentures to Centrue Trust II in exchange for ownership of all the common securities of the trust. The Company is not considered the primary beneficiary of Centrue Trust II; therefore, the trust is not consolidated in the Company's consolidated financial statements, but rather the subordinated debentures, net of unamortized purchase discount, are shown as a liability, and the Company's investment in the common stock of Centrue Trust II of \$0.3 million is included in other assets.

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

All of the subordinated debentures mentioned above may be included in Tier 1 capital (with certain limitations applicable) under current regulatory guidelines and interpretations.

NOTE 16 – INCOME TAXES

The components of income taxes for the years ended December 31, 2021, 2020 and 2019 were as follows:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|---------------------------------|------------------|-----------------|------------------|
| Federal: | | | |
| Current | \$ 10,044 | \$ 10,924 | \$ 2,318 |
| Deferred | 7,926 | (3,852) | 8,287 |
| State: | | | |
| Current | 144 | 1,271 | 1,761 |
| Deferred | (319) | 1,134 | 4,321 |
| Total income tax expense | \$ 17,795 | \$ 9,477 | \$ 16,687 |

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The Company's income tax expense differed from the statutory federal rate of 21% for the years ended December 31, 2021, 2020 and 2019 as follows:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|----------------------------------------------|------------------|-----------------|------------------|
| Expected income taxes | \$ 20,814 | \$ 6,723 | \$ 15,218 |
| Less income tax effect of: | | | |
| Tax-exempt income, net | (2,499) | (2,398) | (2,568) |
| State tax, net of federal benefit | 5,465 | 1,900 | 4,805 |
| State tax settlement, net of federal expense | (5,614) | — | — |
| Equity-based compensation benefit | (93) | 239 | (484) |
| Non-deductible transaction costs | — | — | 110 |
| Disposition of nondeductible goodwill | — | 2,287 | — |
| Valuation allowance | 47 | 10 | 62 |
| Other | (325) | 716 | (456) |
| Actual income tax expense | <u>\$ 17,795</u> | <u>\$ 9,477</u> | <u>\$ 16,687</u> |

On June 29, 2021, the Company announced the settlement of a prior tax issue related to the treatment of gains recognized on FDIC-assisted transactions that resulted in a \$6.8 million tax benefit that was recognized in 2021.

The tax expense associated with the disposition of nondeductible goodwill is related to Love Funding Corporation's asset disposition discussed in Note 2.

Deferred tax assets, net in the accompanying consolidated balance sheets at December 31, 2021 and 2020 include the following amounts of deferred tax assets and liabilities:

| (dollars in thousands) | 2021 | 2020 |
|-----------------------------------------------------|--------------------|-------------------|
| Assets: | | |
| Allowance for credit losses on loans | \$ 14,042 | \$ 16,622 |
| Deferred compensation | 2,177 | 2,152 |
| Loans | 1,835 | 2,772 |
| Tax credits | 1,067 | 1,047 |
| Net operating losses | 10,113 | 11,231 |
| Fair value adjustment on investments | 879 | 1,067 |
| Premises and equipment | — | 433 |
| Operating lease liabilities | 2,946 | 3,289 |
| Other, net | 3,519 | 3,861 |
| Deferred tax assets | 36,578 | 42,474 |
| Valuation allowance | (118) | (71) |
| Deferred tax assets, net of valuation allowance | <u>36,460</u> | <u>42,403</u> |
| Liabilities: | | |
| Premises and equipment | 472 | — |
| Unrealized gain on securities | 569 | 4,169 |
| Mortgage servicing rights | 5,958 | 8,315 |
| Fair value adjustment on trust preferred debentures | 4,264 | 4,417 |
| Deferred loan costs, net of fees | 3,444 | 3,632 |
| Intangible assets | 5,651 | 6,921 |
| Software development costs | 1,446 | 1,522 |
| Leased equipment | 22,297 | 17,910 |
| Operating lease right-of-use assets | 2,318 | 2,524 |
| Other, net | 3,619 | 1,315 |
| Deferred tax liabilities | 50,038 | 50,725 |
| Deferred tax liabilities, net | <u>\$ (13,578)</u> | <u>\$ (8,322)</u> |

At December 31, 2021 and 2020, the accumulation of the prior year's earnings representing tax bad debt deductions was approximately \$3.1 million for both years. If these tax bad debt reserves were charged for losses other than bad debt losses,

the Company would be required to recognize taxable income in the amount of the charge. It is not expected that such tax-restricted retained earnings will be used in a manner that would create federal income tax liabilities.

The Company had \$43.0 million of federal net operating loss carryforwards expiring 2022 through 2035, \$14.0 million of Illinois post-apportioned net operating loss carryforwards expiring in 2026 and 2027, and \$43.0 million of Missouri pre-apportioned net operating loss carryforwards expiring 2022 through 2035, at December 31, 2021. The utilization of the federal and Missouri net operating losses are subject to the limitations of Internal Revenue Code Section 382. The utilization of the Illinois net operating loss is limited to \$100,000 per year for years 2021 through 2023 and the carryforward period will toll in years the Company could have utilized more than \$100,000 of net operating loss.

The Company has state tax credit carryforwards of \$1.3 million with a five year carryforward period, expiring between 2022 and 2026. Any amounts that are expected to expire before being fully utilized have been accounted for through a valuation allowance as discussed below.

We had no unrecognized tax benefits as of December 31, 2021 and 2020, and did not recognize any increase of unrecognized benefits during 2021 relative to any tax positions taken during the year.

Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in other income or expense; no such accruals existed as of December 31, 2021 and 2020.

Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character within the carryback or carryforward period available under the tax law. All available evidence, both positive and negative, should be considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. At December 31, 2021, the Company concluded, based on all available evidence, a valuation allowance was needed for the Company's deferred tax asset related to capital loss carry forwards. An addition was made to the \$0.1 million valuation allowance from December 31, 2020 in the amount of \$0.05 million, resulting in a valuation allowance of \$0.1 million at December 31, 2021 for the estimated capital losses that will not be able to be utilized in the future. For the Company's remaining deferred tax assets, based on our taxpaying history and estimates of taxable income over the years in which the items giving rise to the deferred tax assets are deductible, management believes it is more likely than not that we will realize the benefits of these deductible differences.

The Company is subject to U.S. federal income tax as well as income tax of various states. Years that remain open for potential review by the Internal Revenue Service are 2018 through 2020 and by state taxing authorities are 2017 through 2020.

NOTE 17 – RETIREMENT PLANS

Profit Sharing Plan

We sponsor the Midland States Bank 401(k) Profit Sharing Plan, which provides retirement benefits to substantially all of our employees. There were no employer discretionary profit sharing contributions made to the 401(k) plan in 2021, 2020 and 2019. The 401(k) component of the plan allows participants to defer a portion of their compensation ranging from 1% to 100%. Such deferrals accumulate on a tax deferred basis until the participant withdraws the funds. The Company matches 50% of participant contributions up to 6% of their compensation. Total expense recorded for the Company match was \$1.2 million, \$1.7 million and \$1.7 million for the years ended December 31, 2021, 2020 and 2019, respectively.

Deferred Compensation Arrangements

Certain executive officers participate in a nonqualified deferred compensation arrangement. Beginning in May 2020, the plan is fully funded in a trust controlled by the Company with the gains and losses recognized in other noninterest income. The trust asset is reflected in the Company's equity securities with the offsetting deferred compensation liability reflected in other liabilities. The expense associated with the gains and losses, which are due to the employee upon distribution, is recognized in salaries and employee benefits.

The following table summarizes the activity in the asset and liability balances of the executive officer nonqualified deferred compensation arrangement for the years ended December 31, 2021, 2020 and 2019:

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| (dollars in thousands) | 2021 | 2020 | 2019 |
|----------------------------------------------------|-----------------|-----------------|-----------------|
| Beginning balance, trust asset | \$ 3,657 | \$ — | \$ — |
| Contributions | 207 | 3,264 | — |
| Gain on trust assets | 359 | 499 | — |
| Distributions | (509) | (106) | — |
| Ending balance, trust asset | <u>\$ 3,714</u> | <u>\$ 3,657</u> | <u>\$ —</u> |
| Beginning balance, deferred compensation liability | \$ 3,657 | \$ 2,978 | \$ 2,383 |
| Deferred compensation | 207 | 350 | 751 |
| Expense on deferred compensation liability | 359 | 506 | 8 |
| Distributions | (509) | (177) | (164) |
| Ending balance, deferred compensation liability | <u>\$ 3,714</u> | <u>\$ 3,657</u> | <u>\$ 2,978</u> |

Certain directors also participate in a nonqualified deferred compensation arrangement. The deferred compensation liability is reflected in other liabilities with the associated expense recognized in other noninterest expense.

The following table summarizes the activity in the liability balance of the director nonqualified deferred compensation arrangement for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|----------------------------------------------------|-----------------|-----------------|-----------------|
| Beginning balance, deferred compensation liability | \$ 4,560 | \$ 5,007 | \$ 4,135 |
| Deferred compensation | 606 | 586 | 679 |
| Expense on deferred compensation liability | 251 | 270 | 236 |
| Distributions | (45) | (1,303) | (43) |
| Ending balance, deferred compensation liability | <u>\$ 5,372</u> | <u>\$ 4,560</u> | <u>\$ 5,007</u> |

Defined Benefit Pension Plan

The Bank participated in the Pentegra Defined Benefit Plan for Financial Institutions, a non-contributory defined benefit pension plan for certain former employees of Heartland Bank who met prescribed eligibility requirements. The multiple-employer plan operates as a single plan under Internal Revenue Code Section 413(c) and, as a result, all of the amounts contributed by the participating institutions are maintained in the aggregate. The plan was funded based on an annual valuation performed by the plan administrator. For Heartland Bank participants, benefits under the plan were frozen July 1, 2004. The funded status of the plan (allocated market value of assets divided by funding target associated with Heartland Bank participants) was 141.37% as of July 1, 2021, the latest actuarial valuation date. The minimum required contribution for 2021 and 2020 was \$0.1 million and \$0.2 million, respectively.

Effective October 1, 2021, the Bank withdrew from the multiple-employer plan by transferring assets and liabilities to a qualified successor plan under actuarial assumptions and methodology determined appropriate by Pentegra. Assets of \$16.6 million were transferred to the successor plan on November 30, 2021. Transferred liability excludes the previously allocated orphan liability. For minimum funding purposes, this single-employer plan operates under Internal Revenue Code Sections 430 and 436. The successor plan would remain above 100% funded if valued as of July 1, 2021, and the minimum required contribution for 2022 is expected to be zero.

Previously, costs for administration, shortfalls in funds to maintain the frozen level of benefit coverage and differences of actuarial assumptions related to the frozen benefits were expensed as incurred. As a result, there is no recognized accrued or prepaid pension cost as of December 31, 2021. Initial application of ASC 715 to the successor plan will result in a transition asset or obligation equal to the plan's funded status. For future periods, the net periodic benefit cost will vary from contributions made during the year.

NOTE 18 – SHARE-BASED COMPENSATION

The Company awards select employees and directors certain forms of share-based incentives under a long-term incentive plan approved by the Company's shareholders. The Company grants these awards under the Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan ("2019 Incentive Plan"). The 2019 Incentive Plan made 1,000,000 shares available to be issued to selected employees and directors of, and service providers to, the Company or its subsidiaries. The granting of awards under this plan can be in the form of stock options, stock appreciation rights, stock awards and cash incentive awards. The awards are granted by the compensation committee, which is comprised of members of the board of directors.

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Previously, the Company granted equity awards under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (“2010 Incentive Plan”). Following approval of our 2019 Incentive Plan, no additional awards may be granted from our 2010 Incentive Plan; however, any previously granted award will remain subject to the terms of the 2010 Incentive Plan for so long as they remain outstanding.

Total compensation cost that has been charged against income under the plans was \$1.9 million, \$2.2 million and \$2.0 million for the years ended December 31, 2021, 2020 and 2019, respectively.

Restricted Stock

The Company granted 128,049 and 94,998 shares of restricted stock awards in 2021 and 2020, respectively. These awards have a vesting period of four years. Compensation expense is recognized over the vesting period of the award based on the fair value of the stock at the date of grant.

A summary of the activity for restricted stock awards and restricted stock unit awards for the year follows:

| | Number outstanding | Weighted average grant due fair value |
|------------------------------|-----------------------|------------------------------------------------|
| Nonvested, beginning of year | 233,010 | \$ 22.64 |
| Granted | 128,049 | 25.67 |
| Vested | (77,319) | 24.60 |
| Forfeited | <u>(21,922)</u> | 21.66 |
| Nonvested, end of year | <u>261,818</u> | <u>\$ 23.62</u> |

As of December 31, 2021, there was \$5.6 million of total unrecognized compensation cost related to the nonvested shares granted under the plans. The cost is expected to be recognized over a weighted average period of 3.0 years.

The weighted average grant date fair value for restricted stock awards was \$25.67, \$14.85 and \$27.67 during the years ended December 31, 2021, 2020 and 2019, respectively.

Stock Options

The Company did not grant stock options in any of the years ended December 31, 2021, 2020 and 2019. All stock options outstanding are related to grants from prior years.

The summary of our stock option activity during the years ended December 31, 2021 and 2020 is as follows:

| | 2021 | | | 2020 | | |
|---------------------------------------|----------------|---------------------------------------|---------------------------------------------------------|----------------|---------------------------------------|---------------------------------------------------------|
| | Shares | Weighted average exercise price | Weighted average remaining contractual life | Shares | Weighted average exercise price | Weighted average remaining contractual life |
| Option outstanding, beginning of year | 467,489 | \$ 21.40 | | 623,122 | \$ 20.83 | |
| Options granted | — | — | | — | — | |
| Options exercised | (116,147) | 19.16 | | (39,500) | 17.90 | |
| Options forfeited | — | — | | (3,268) | 28.89 | |
| Options expired | (26,548) | 27.07 | | (112,865) | 19.26 | |
| Options outstanding, end of year | <u>324,794</u> | 21.74 | 3.1 years | <u>467,489</u> | 21.40 | 4.1 years |
| Options exercisable | 324,794 | 21.74 | 3.1 years | 463,590 | 21.31 | 4.1 years |
| Options vested and expected to vest | 324,794 | 21.74 | 3.1 years | 467,060 | 21.39 | 4.1 years |

The aggregate intrinsic value of options outstanding and exercisable as of December 31, 2021 was \$1.3 million.

The total intrinsic value and cash received from options exercised under share-based payment arrangements was \$0.8 million and \$2.2 million, respectively, for the year ended December 31, 2021, \$0.2 million and \$0.7 million, respectively, for the year ended December 31, 2020, and \$3.6 million and \$5.9 million, respectively, for the year ended December 31, 2019.

The following table summarizes information about the Company's nonvested stock option activity for 2021:

| | Shares | Weighted average grant date fair value |
|------------------------------|-----------------|-------------------------------------------------|
| Nonvested, beginning of year | 3,899 | \$ 4.33 |
| Granted | — | — |
| Vested | (3,899) | 4.33 |
| Forfeited | — | — |
| Nonvested, end of year | <u><u>—</u></u> | <u><u>—</u></u> |

NOTE 19 – EARNINGS PER SHARE

Earnings per share are calculated utilizing the two-class method. Basic earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of common shares outstanding. Diluted earnings per share are calculated by dividing the sum of distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of shares adjusted for the dilutive effect of common stock awards. The diluted earnings per share computation for the years ended December 31, 2021, 2020 and 2019 excluded antidilutive stock options of 65,033, 364,272 and 91,097, respectively, because the exercise prices of these stock options exceeded the average market prices of the Company's common shares for those respective years. Presented below are the calculations for basic and diluted earnings per common share for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands, except share and per share data) | 2021 | 2020 | 2019 |
|--------------------------------------------------------------------------|-------------------|-------------------|-------------------|
| Net income | \$ 81,317 | \$ 22,537 | \$ 55,784 |
| Preferred dividends declared | — | — | (191) |
| Preferred stock, premium amortization | — | — | 145 |
| Net income available to common shareholders | 81,317 | 22,537 | 55,738 |
| Common shareholder dividends | (24,912) | (24,699) | (23,389) |
| Unvested restricted stock award dividends | (260) | (259) | (210) |
| Undistributed earnings to unvested restricted stock awards | (564) | — | (267) |
| Undistributed earnings to common shareholders | <u>\$ 55,581</u> | <u>\$ (2,421)</u> | <u>\$ 31,872</u> |
| Basic | | | |
| Distributed earnings to common shareholders | \$ 24,912 | \$ 24,699 | \$ 23,389 |
| Undistributed earnings to common shareholders | 55,581 | (2,421) | 31,872 |
| Total common shareholders earnings, basic | <u>\$ 80,493</u> | <u>\$ 22,278</u> | <u>\$ 55,261</u> |
| Diluted | | | |
| Distributed earnings to common shareholders | \$ 24,912 | \$ 24,699 | \$ 23,389 |
| Undistributed earnings to common shareholders | 55,581 | (2,421) | 31,872 |
| Total common shareholders earnings | <u>80,493</u> | <u>22,278</u> | <u>55,261</u> |
| Add back: | | | |
| Undistributed earnings reallocated from unvested restricted stock awards | 2 | — | 2 |
| Total common shareholders earnings, diluted | <u>\$ 80,495</u> | <u>\$ 22,278</u> | <u>\$ 55,263</u> |
| Weighted average common shares outstanding, basic | 22,481,389 | 23,336,881 | 24,288,793 |
| Options | 65,964 | 9,245 | 204,638 |
| Weighted average common shares outstanding, diluted | <u>22,547,353</u> | <u>23,346,126</u> | <u>24,493,431</u> |
| Basic earnings per common share | \$ 3.58 | \$ 0.95 | \$ 2.28 |
| Diluted earnings per common share | 3.57 | 0.95 | 2.26 |

NOTE 20 – CAPITAL REQUIREMENTS

The Company's primary source of cash is dividends received from the Bank. The Bank is restricted by Illinois law and regulations of the Illinois Department of Financial and Professional Regulation and the FDIC as to the maximum amount of dividends the Bank can pay to us. As a practical matter, the Bank restricts dividends to a lesser amount because of the need to maintain an adequate capital structure.

We are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet regulatory capital requirements may result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for "prompt corrective action", we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting policies. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Total capital, Tier 1 capital and Common Equity Tier 1 capital to risk-weighted assets (as defined in the regulations), and of Tier 1 capital to average assets (as defined in the regulations).

Beginning on January 1, 2016, a capital conservation buffer became effective for banking organizations. The capital conservation buffer, which consists of Common Equity Tier 1 capital, is not a minimum capital requirement; however, the capital conservation buffer is designed to establish a capital range above minimum requirements to insulate banks from periods of stress and impose constraints on dividends, share repurchases and discretionary bonus payments when capital levels fall below prescribed levels. In order to not be subject to required restrictions on dividends, share repurchases and discretionary bonus payments, banking organizations must maintain minimum ratios of (i) Common Equity Tier 1 capital to risk-weighted assets of at least 4.5% plus the 2.5% capital conservation buffer, (ii) Tier 1 capital to risk-weighted assets of at least 6.0% plus the 2.5% capital conservation buffer, (iii) Total capital to risk-weighted assets of at least 8.0% plus the 2.5% capital conservation buffer, and (iv) Tier 1 capital to adjusted average consolidated assets of at least 4.0%.

In December 2018, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard. In March 2020, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the FDIC published an interim final rule to delay the estimated impact on regulatory capital stemming from the implementation of CECL. The interim final rule maintains the three-year transition option in the previous rule and provides banks the option to delay for two years an estimate of CECL's effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period (five-year transition option). The Company adopted the capital transition relief over the permissible five-year period.

At December 31, 2021, the Company and the Bank exceeded the regulatory minimums to which they were subject and exceeded the regulatory definition of well-capitalized.

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At December 31, 2021 and 2020, the Company's and the Bank's actual and required capital ratios were as follows:

| (dollars in thousands) | Actual | | Fully Phased-In Regulatory Guidelines Minimum | | Required to be Well Capitalized Under Prompt Corrective Action Requirements | |
|-----------------------------------------------|------------|---------|-----------------------------------------------------|---------|--------------------------------------------------------------------------------------|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | | | | |
| December 31, 2021 | | | | | | |
| Total risk-based capital ratio | | | | | | |
| Midland States Bancorp, Inc. | \$ 732,177 | 12.19 % | \$ 630,482 | 10.50 % | N/A | N/A |
| Midland States Bank | 672,500 | 11.21 | 629,911 | 10.50 | \$ 599,915 | 10.00% |
| Tier 1 risk-based capital ratio | | | | | | |
| Midland States Bancorp, Inc. | 550,195 | 9.16 | 510,390 | 8.50 | N/A | N/A |
| Midland States Bank | 629,389 | 10.49 | 509,928 | 8.50 | 479,932 | 8.00 |
| Common equity tier 1 risk-based capital ratio | | | | | | |
| Midland States Bancorp, Inc. | 485,244 | 8.08 | 420,321 | 7.00 | N/A | N/A |
| Midland States Bank | 629,389 | 10.49 | 419,940 | 7.00 | 389,945 | 6.50 |
| Tier 1 leverage ratio | | | | | | |
| Midland States Bancorp, Inc. | 550,195 | 7.75 | 283,941 | 4.00 | N/A | N/A |
| Midland States Bank | 629,389 | 8.89 | 283,324 | 4.00 | 354,156 | 5.00 |
| December 31, 2020 | | | | | | |
| Total risk-based capital ratio | | | | | | |
| Midland States Bancorp, Inc. | \$ 710,417 | 13.24 % | \$ 563,610 | 10.50 % | N/A | N/A |
| Midland States Bank | 631,585 | 11.77 | 563,420 | 10.50 | \$ 536,591 | 10.00% |
| Tier 1 risk-based capital ratio | | | | | | |
| Midland States Bancorp, Inc. | 494,043 | 9.20 | 456,256 | 8.50 | N/A | N/A |
| Midland States Bank | 578,681 | 10.78 | 456,102 | 8.50 | 429,273 | 8.00 |
| Common equity tier 1 risk-based capital ratio | | | | | | |
| Midland States Bancorp, Inc. | 429,092 | 7.99 | 375,740 | 7.00 | N/A | N/A |
| Midland States Bank | 578,681 | 10.78 | 375,614 | 7.00 | 348,784 | 6.50 |
| Tier 1 leverage ratio | | | | | | |
| Midland States Bancorp, Inc. | 494,043 | 7.50 | 263,651 | 4.00 | N/A | N/A |
| Midland States Bank | 578,681 | 8.78 | 263,537 | 4.00 | 329,421 | 5.00 |

NOTE 21 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting assumptions that a market participant would use when pricing an asset or liability. The hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows:

- Level 1: Unadjusted quoted prices for identical assets or liabilities traded in active markets.
- Level 2: Significant other observable inputs other than Level 1, including quoted prices for similar assets and liabilities in active markets, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

Investment securities. The fair value of investment securities available for sale are determined by quoted market prices, if available (Level 1). For investment securities available for sale where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For investment securities available for sale where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other

market indicators (Level 3). Securities classified as Level 3 are not actively traded, and as a result, fair value is determined utilizing third-party valuation services through consensus pricing. There were no transfers between Levels 1, 2 or 3 during the years ended December 31, 2021 or 2020 for assets measured at fair value on a recurring basis. The fair value of equity securities is determined using quoted prices or market prices for similar securities (Level 2).

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

Derivative instruments. The fair value of derivative instruments are determined based on derivative valuation models using observable market data as of the measurement date (Level 2).

Loan servicing rights. In accordance with GAAP, the Company records impairment charges on loan servicing rights on a non-recurring basis when the carrying value exceeds the estimated fair value. The fair value of our servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, replacement reserves and other economic factors which are estimated based on current market conditions (Level 3).

Mortgage servicing rights held for sale. The fair value of mortgage servicing rights held for sale is determined by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs and other economic factors which are estimated based on current market conditions, less costs to sell (Level 3).

Nonperforming loans. Nonperforming loans are measured and recorded at fair value on a non-recurring basis. All of our nonaccrual loans and restructured loans are considered nonperforming and are reviewed individually for the amount of impairment, if any. Most of our loans are collateral dependent and, accordingly, we measure nonperforming loans based on the estimated fair value of such collateral. The fair value of each loan's collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the cost related to liquidating such collateral (Level 2). When adjustments are made to an appraised value to reflect various factors such as the age of the appraisal or known changes in the market or the collateral, such valuation inputs are considered unobservable (Level 3). The nonperforming loans categorized as Level 3 also include unsecured loans and other secured loans whose fair values are based significantly on unobservable inputs such as the strength of a guarantor, cash flows discounted at the effective loan rate, and management's judgment.

Assets held for sale. Assets held for sale represent the fair value of the banking facilities that are expected to be sold. The fair value of the assets held for sale was based on estimated market prices from independently prepared current appraisals (Level 2).

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Assets and liabilities measured and recorded at fair value, including financial assets for which the Company has elected the fair value option, on a recurring and non-recurring basis at December 31, 2021 and 2020, are summarized below:

| | 2021 | | | |
|---------------------------------------------------------------------|-------------------|-------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
| | Total | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| (dollars in thousands) | | | | |
| Assets and liabilities measured at fair value on a recurring basis: | | | | |
| Assets | | | | |
| Investment securities available for sale: | | | | |
| U.S. Treasury securities | \$ 64,917 | \$ 64,917 | \$ — | \$ — |
| U.S. government sponsored entities and U.S. agency securities | 33,817 | — | 33,817 | — |
| Mortgage-backed securities - agency | 440,270 | — | 440,270 | — |
| Mortgage-backed securities - non-agency | 28,706 | — | 28,706 | — |
| State and municipal securities | 143,099 | — | 143,099 | — |
| Corporate securities | 195,794 | — | 194,859 | 935 |
| Equity securities | 9,529 | 9,529 | — | — |
| Loans held for sale | 32,045 | — | 32,045 | — |
| Interest rate lock commitments | 410 | — | 410 | — |
| Interest rate swap contracts | 5,473 | — | 5,473 | — |
| Total | <u>\$ 954,060</u> | <u>\$ 74,446</u> | <u>\$ 878,679</u> | <u>\$ 935</u> |
| Liabilities | | | | |
| Forward commitments to sell mortgage-backed securities | \$ 19 | \$ — | \$ 19 | \$ — |
| Interest rate swap contracts | 378 | — | 378 | — |
| Total | <u>\$ 397</u> | <u>\$ —</u> | <u>\$ 397</u> | <u>\$ —</u> |
| Assets measured at fair value on a non-recurring basis: | | | | |
| Loan servicing rights | \$ 28,865 | \$ — | \$ — | \$ 28,865 |
| Nonperforming loans | 36,542 | 24,358 | 6,129 | 6,055 |
| Other real estate owned | 12,059 | — | 12,059 | — |
| Assets held for sale | 2,284 | — | 2,284 | — |

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| (dollars in thousands) | Total | 2020 | | |
|---------------------------------------------------------------------|-------------------|-------------------------------------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------|
| | | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets and liabilities measured at fair value on a recurring basis: | | | | |
| Assets | | | | |
| Investment securities available for sale: | | | | |
| U.S. government sponsored entities and U.S. agency securities | \$ 35,567 | \$ — | \$ 35,567 | \$ — |
| Mortgage-backed securities - agency | 344,577 | — | 344,577 | — |
| Mortgage-backed securities - non-agency | 20,744 | — | 20,744 | — |
| State and municipal securities | 129,765 | — | 129,765 | — |
| Corporate securities | 146,058 | — | 145,099 | 959 |
| Equity securities | 9,424 | 9,424 | — | — |
| Loans held for sale | 138,090 | — | 138,090 | — |
| Interest rate lock commitments | 2,217 | — | 2,217 | — |
| Interest rate swap contracts | 1,206 | — | 1,206 | — |
| Total | <u>\$ 827,648</u> | <u>\$ 9,424</u> | <u>\$ 817,265</u> | <u>\$ 959</u> |
| Liabilities | | | | |
| Forward commitments to sell mortgage-backed securities | \$ 309 | \$ — | \$ 309 | \$ — |
| Interest rate swap contracts | 803 | — | 803 | — |
| Total | <u>\$ 1,112</u> | <u>\$ —</u> | <u>\$ 1,112</u> | <u>\$ —</u> |
| Assets measured at fair value on a non-recurring basis: | | | | |
| Loan servicing rights | \$ 28,865 | \$ — | \$ — | \$ 39,276 |
| Mortgage servicing rights held for sale | 878 | — | — | 878 |
| Nonperforming loans | 13,333 | — | 12,054 | 1,279 |
| Other real estate owned | 20,247 | — | 20,247 | — |
| Assets held for sale | 4,157 | — | 4,157 | — |

The following table provides a reconciliation of activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2021 and 2020:

| (dollars in thousands) | Corporate Securities | |
|---------------------------------------------------------------|-----------------------------|---------------|
| | 2021 | 2020 |
| Balance, beginning of period | \$ 959 | \$ 955 |
| Total realized in earnings ⁽¹⁾ | 14 | 8 |
| Total unrealized in other comprehensive income ⁽²⁾ | (24) | 4 |
| Net settlements (principal and interest) | (14) | (8) |
| Balance, end of period | <u>\$ 935</u> | <u>\$ 959</u> |

(1) Amounts included in interest income from investment securities taxable in the consolidated statements of income.

(2) Represents change in unrealized gains or losses for the period included in other comprehensive income for assets held at the end of the reporting period.

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The following table provides quantitative information about significant unobservable inputs used in fair value measurements of Level 3 assets measured at fair value on a recurring basis at December 31, 2021 and 2020:

| (dollars in thousands) | Fair value | Valuation technique | Unobservable input / assumptions | Range (weighted average) ⁽¹⁾ |
|--------------------------|------------|---------------------|----------------------------------|-----------------------------------------|
| December 31, 2021 | | | | |
| Corporate securities | \$ 935 | Consensus pricing | Net market price | 0.0 % — 7.0% (4.5)% |
| December 31, 2020 | | | | |
| Corporate securities | \$ 959 | Consensus pricing | Net market price | (2.0)% — 4.9% (2.0)% |

(1) Unobservable inputs were weighted by the relative fair value of the instruments.

The significant unobservable inputs used in the fair value measurement of the Company's corporate securities is net market price. The corporate securities are not actively traded, and as a result, fair value is determined utilizing third-party valuation services through consensus pricing. Significant changes in any of the inputs in isolation would result in a significant change in the fair value measurement. Generally, net market price increases when market interest rates decline and declines when market interest rates increase.

The following table presents (gains) losses recognized on assets measured on a non-recurring basis for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|-------------------------------------------------------|------------------|------------------|------------------|
| Loan servicing rights | \$ 7,532 | \$ 12,337 | \$ 2,139 |
| Mortgage servicing rights held for sale | 222 | 1,692 | (490) |
| Nonperforming loans | 14,468 | 24,611 | 10,259 |
| Other real estate owned | 454 | 1,390 | 16 |
| Assets held for sale | — | 10,404 | 3,577 |
| Total loss on assets measured on a nonrecurring basis | <u>\$ 22,676</u> | <u>\$ 50,434</u> | <u>\$ 15,501</u> |

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The following table presents quantitative information about significant unobservable inputs used in the fair value measurements of Level 3 assets measured on a non-recurring basis at December 31, 2021 and 2020:

| (dollars in thousands) | Fair Value | Valuation technique | Unobservable input / assumptions | Range (weighted average) | | | |
|-------------------------------|------------|----------------------|----------------------------------|--------------------------|----------|--|--|
| December 31, 2021 | | | | | | | |
| <i>Loan servicing rights:</i> | | | | | | | |
| Commercial MSR | \$ 28,368 | Discounted cash flow | Prepayment speed | 8.00% - 18.00% | (8.24)% | | |
| | | | Discount rate | 10.00% - 27.00% | (11.87)% | | |
| SBA servicing rights | \$ 898 | Discounted cash flow | Prepayment speed | 12.27% - 14.14% | (13.88)% | | |
| | | | Discount rate | 10.00% - 12.00% | (11.00)% | | |
| Residential MSR | \$ 705 | Discounted cash flow | Prepayment speed | 11.94% - 27.48% | (14.94)% | | |
| | | | Discount rate | 9.00% - 11.50% | (10.25)% | | |
| December 31, 2020 | | | | | | | |
| <i>Loan servicing rights:</i> | | | | | | | |
| Commercial MSR | \$ 38,322 | Discounted cash flow | Prepayment speed | 8.00% - 18.00% | (8.18)% | | |
| | | | Discount rate | 10.00% - 27.00% | (11.48)% | | |
| SBA servicing rights | \$ 954 | Discounted cash flow | Prepayment speed | 12.01% — 12.52% | (12.25)% | | |
| | | | Discount rate | No range | (11.00)% | | |
| MSR held for sale | \$ 878 | Discounted cash flow | Prepayment speed | 14.40% — 26.28% | (20.34)% | | |
| | | | Discount rate | 9.00% — 11.50% | (10.13)% | | |

ASC Topic 825, *Financial Instruments*, requires disclosure of the estimated fair value of certain financial instruments and the methods and significant assumptions used to estimate such fair values. Additionally, certain financial instruments and all nonfinancial instruments are excluded from the applicable disclosure requirements.

The Company has elected the fair value option for newly originated residential and commercial loans held for sale. These loans are intended for sale and are hedged with derivative instruments. We have elected the fair value option to mitigate accounting mismatches in cases where hedge accounting is complex and to achieve operational simplification.

The following table presents the difference between the aggregate fair value and the aggregate remaining principal balance for loans for which the fair value option has been elected at December 31, 2021 and 2020:

| (dollars in thousands) | 2021 | | | 2020 | | |
|---------------------------------|----------------------|---------------|-----------------------|----------------------|---------------|-----------------------|
| | Aggregate fair value | Difference | Contractual principal | Aggregate fair value | Difference | Contractual principal |
| Commercial loans held for sale | \$ 19,230 | \$ — | \$ 19,230 | \$ 126,123 | \$ 67 | \$ 126,056 |
| Residential loans held for sale | 12,815 | 584 | 12,231 | 11,967 | 743 | 11,224 |
| Total loans held for sale | <u>\$ 32,045</u> | <u>\$ 584</u> | <u>\$ 31,461</u> | <u>\$ 138,090</u> | <u>\$ 810</u> | <u>\$ 137,280</u> |

The following table presents the amount of gains (losses) from fair value changes included in income before income taxes for financial assets carried at fair value for the years ended December 31, 2021, 2020 and 2019:

| (dollars in thousands) | 2021 | 2020 | 2019 |
|---------------------------------|-----------------|---------------|-----------------|
| Commercial loans held for sale | \$ (67) | \$ (139) | \$ (389) |
| Residential loans held for sale | (148) | 318 | 7 |
| Total loans held for sale | <u>\$ (215)</u> | <u>\$ 179</u> | <u>\$ (382)</u> |

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The carrying values and estimated fair value of financial instruments not carried at fair value at December 31, 2021 and 2020 were as follows:

| | | 2021 | | | |
|-----------------------------|-----------------|--------------|----------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
| (dollars in thousands) | Carrying Amount | Fair Value | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets | | | | | |
| Cash and due from banks | \$ 673,297 | \$ 673,297 | \$ 673,297 | \$ — | \$ — |
| Federal funds sold | 7,074 | 7,074 | 7,074 | — | — |
| Loans, net | 5,173,739 | 5,221,886 | — | — | 5,221,886 |
| Accrued interest receivable | 19,470 | 19,470 | — | 19,470 | — |
| Liabilities | | | | | |
| Deposits | \$ 6,110,648 | \$ 6,109,077 | \$ — | \$ 6,109,077 | \$ — |
| Short-term borrowings | 76,803 | 76,803 | — | 76,803 | — |
| FHLB and other borrowings | 310,171 | 317,464 | — | 317,464 | — |
| Subordinated debt | 139,091 | 148,386 | — | 148,386 | — |
| Trust preferred debentures | 49,374 | 57,827 | — | 57,827 | — |
| Accrued interest payable | 2,848 | 2,848 | — | 2,848 | — |
| | | | | | |
| 2020 | | | | | |
| (dollars in thousands) | Carrying Amount | Fair Value | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets | | | | | |
| Cash and due from banks | \$ 337,080 | \$ 337,080 | \$ 337,080 | \$ — | \$ — |
| Federal funds sold | 4,560 | 4,560 | 4,560 | — | — |
| Loans, net | 5,042,888 | 5,006,223 | — | — | 5,006,223 |
| Accrued interest receivable | 23,545 | 23,545 | — | 23,545 | — |
| Liabilities | | | | | |
| Deposits | \$ 5,101,016 | \$ 5,108,360 | \$ — | \$ 5,108,360 | \$ — |
| Short-term borrowings | 68,957 | 68,957 | — | 68,957 | — |
| FHLB and other borrowings | 779,171 | 807,493 | — | 807,493 | — |
| Subordinated debt | 169,795 | 176,504 | — | 176,504 | — |
| Trust preferred debentures | 48,814 | 50,165 | — | 50,165 | — |
| Accrued interest payable | 4,441 | 4,441 | — | 4,441 | — |

In accordance with our adoption of ASU 2016-1 in 2020, the methods utilized to measure the fair value of financial instruments at December 31, 2021 and 2020 represent an approximation of exit price; however, an actual exit price may differ.

NOTE 22 – COMMITMENTS, CONTINGENCIES AND CREDIT RISK

The spread of the COVID virus had an impact on our operations, and the Company expects that the virus will continue to have an impact on the business, financial condition, and results of operations of the Company and its customers. The COVID pandemic caused changes in the behavior of customers, businesses, and their employees, including illness, quarantines, social distancing practices, cancellation of events and travel, business and school shutdowns, reduction in commercial activity and financial transactions, supply chain interruptions, increased unemployment, and overall economic and financial market instability. Future effects, including additional actions taken by federal, state, and local governments to contain COVID or treat its impact, are unknown. However, if these actions are sustained, it may adversely impact several industries within our geographic footprint and impair the ability of our customers to fulfill their contractual obligations to the Company. This could cause the Company to experience a material adverse effect on our business operations, asset valuations, financial condition, and

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results of operations. Material adverse impacts may include all or a combination of valuation impairments on our intangible assets, investments, loans, loan servicing rights, deferred tax assets, or counter-party risk derivatives.

In the normal course of business, there are outstanding various contingent liabilities, such as claims and legal actions, which are not reflected in the consolidated financial statements. No material losses are anticipated as a result of these actions or claims.

We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank used the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The commitments are principally tied to variable rates. Loan commitments at December 31, 2021 and 2020 were as follows:

| (dollars in thousands) | 2021 | 2020 |
|--------------------------------------------------|------------|------------|
| Commitments to extend credit | \$ 994,709 | \$ 894,212 |
| Financial guarantees – standby letters of credit | 14,325 | 15,889 |

The Company establishes a mortgage repurchase liability to reflect management's estimate of losses on loans for which the Company could have a repurchase obligation based on the volume of loans sold in 2021 and years prior, borrower default expectations, historical investor repurchase demand and appeals success rates, and estimated loss severity. Loans repurchased from investors are initially recorded at fair value, which becomes the Company's new accounting basis. Any difference between the loan's fair value and the outstanding principal amount is charged or credited to the mortgage repurchase liability, as appropriate. Subsequent to repurchase, such loans are carried in loans receivable. There were no losses as a result of make-whole requests and loan repurchases for the years ended December 31, 2021, 2020 and 2019. The liability for unresolved repurchase demands totaled \$0.2 million at December 31, 2021 and 2020.

NOTE 23 – SEGMENT INFORMATION

Our business segments are defined as Banking, Wealth Management, and Other. The reportable business segments are consistent with the internal reporting and evaluation of the principle lines of business of the Company. The banking segment provides a wide range of financial products and services to consumers and businesses, including commercial, commercial real estate, mortgage and other consumer loan products; commercial equipment leasing; mortgage loan sales and servicing; letters of credit; various types of deposit products, including checking, savings and time deposit accounts; merchant services; and corporate treasury management services. The wealth management segment consists of trust and fiduciary services, brokerage and retirement planning services. The other segment includes the operating results of the parent company, our captive insurance business unit, and the elimination of intercompany transactions.

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Selected business segment financial information as of and for the years ended December 31, 2021, 2020 and 2019 were as follows:

| (dollars in thousands) | Banking | Wealth Management | Other | Total |
|---------------------------------------------|--------------|-------------------|--------------|--------------|
| December 31, 2021 | | | | |
| Net interest income (expense) | \$ 218,309 | \$ — | \$ (10,634) | \$ 207,675 |
| Provision for credit losses on loans | 3,393 | — | — | 3,393 |
| Noninterest income | 42,249 | 26,876 | 774 | 69,899 |
| Noninterest expense | 158,803 | 17,372 | (1,106) | 175,069 |
| Income (loss) before income taxes (benefit) | 98,362 | 9,504 | (8,754) | 99,112 |
| Income taxes (benefit) | 17,218 | 2,679 | (2,102) | 17,795 |
| Net income (loss) | \$ 81,144 | \$ 6,825 | \$ (6,652) | \$ 81,317 |
| Total assets | \$ 7,460,114 | \$ 28,883 | \$ (45,192) | \$ 7,443,805 |
| December 31, 2020 | | | | |
| Net interest income (expense) | \$ 211,120 | \$ — | \$ (11,984) | \$ 199,136 |
| Provision for credit losses on loans | 44,361 | — | — | 44,361 |
| Noninterest income | 38,706 | 22,802 | (259) | 61,249 |
| Noninterest expense | 170,025 | 14,938 | (953) | 184,010 |
| Income (loss) before income taxes (benefit) | 35,440 | 7,864 | (11,290) | 32,014 |
| Income taxes (benefit) | 10,020 | 2,194 | (2,737) | 9,477 |
| Net income (loss) | \$ 25,420 | \$ 5,670 | \$ (8,553) | \$ 22,537 |
| Total assets | \$ 6,983,254 | \$ 29,069 | \$ (143,783) | \$ 6,868,540 |
| December 31, 2019 | | | | |
| Net interest income (expense) | \$ 201,534 | \$ — | \$ (11,719) | \$ 189,815 |
| Provision for credit losses on loans | 16,985 | — | — | 16,985 |
| Noninterest income | 53,683 | 21,832 | (233) | 75,282 |
| Noninterest expense | 160,364 | 14,850 | 427 | 175,641 |
| Income (loss) before income taxes (benefit) | 77,868 | 6,982 | (12,379) | 72,471 |
| Income taxes (benefit) | 18,195 | 1,850 | (3,358) | 16,687 |
| Net income (loss) | \$ 59,673 | \$ 5,132 | \$ (9,021) | \$ 55,784 |
| Total assets | \$ 6,085,441 | \$ 27,521 | \$ (25,945) | \$ 6,087,017 |

NOTE 24 – REVENUE FROM CONTRACTS WITH CUSTOMERS

The Company's revenue from contracts with customers in the scope of Topic 606 is recognized within noninterest income in the consolidated statements of income. The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the years ended December 31, 2021, 2020 and 2019.

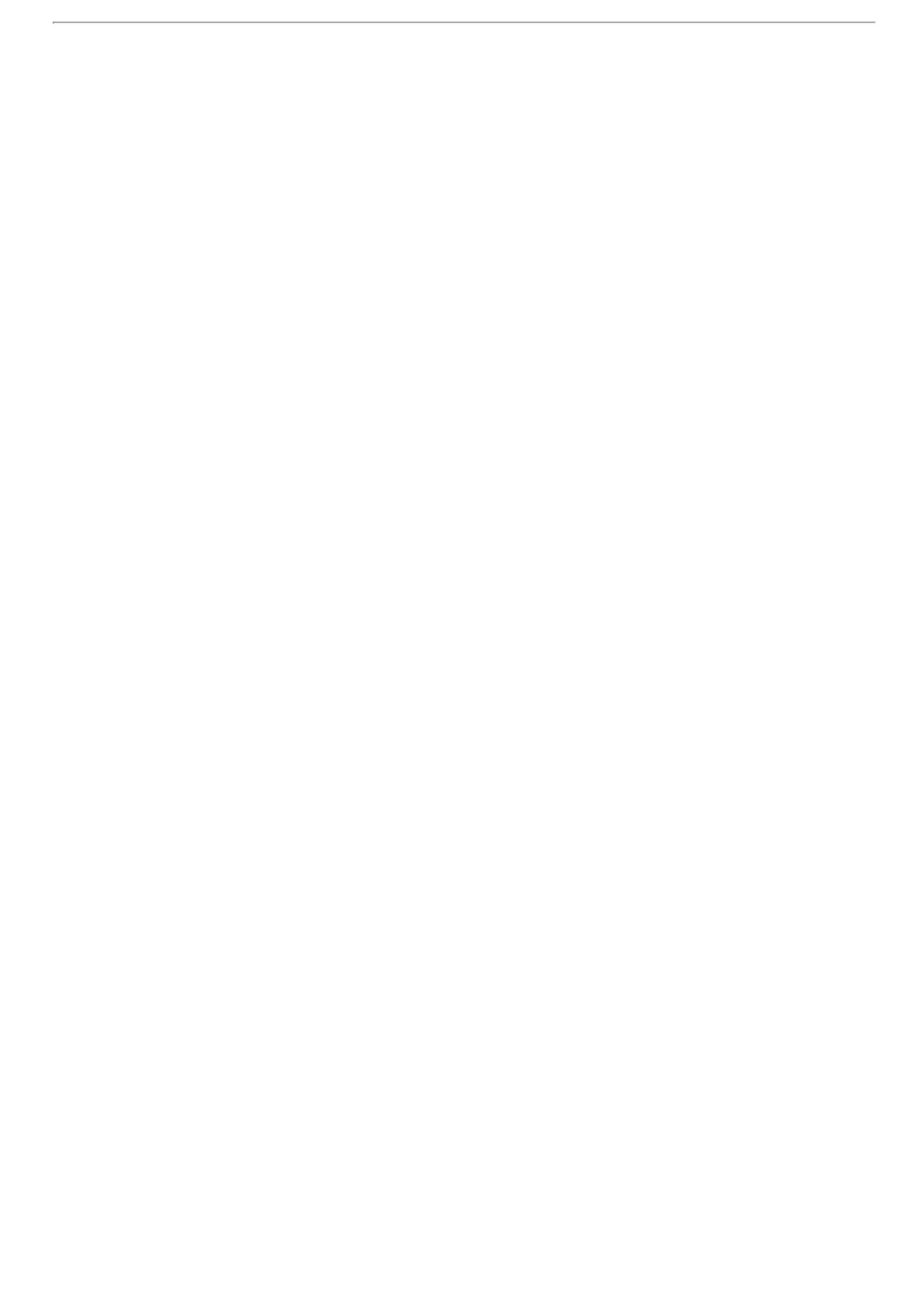
| (dollars in thousands) | 2021 | 2020 | 2019 |
|-------------------------------------------------------|------------------|------------------|------------------|
| Noninterest income - in-scope of Topic 606 | | | |
| <i>Wealth management revenue:</i> | | | |
| Trust management/administration fees | \$ 20,954 | \$ 16,953 | \$ 16,114 |
| Investment advisory fees | 1,282 | 2,009 | 2,171 |
| Investment brokerage fees | 2,050 | 1,465 | 1,165 |
| Other | 2,525 | 2,375 | 2,382 |
| <i>Service charges on deposit accounts:</i> | | | |
| Nonsufficient fund fees | 5,339 | 5,589 | 7,721 |
| Other | 3,009 | 3,014 | 3,306 |
| <i>Interchange revenues</i> | 14,500 | 12,266 | 11,992 |
| <i>Other income:</i> | | | |
| Merchant services revenue | 1,511 | 1,381 | 1,506 |
| Other | 3,850 | 3,161 | 3,475 |
| Noninterest income - out-of-scope of Topic 606 | 14,879 | 13,036 | 25,450 |
| Total noninterest income | \$ 69,899 | \$ 61,249 | \$ 75,282 |

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

Wealth Management Revenue. Wealth management revenue is primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company also earns investment advisory fees through its SEC registered investment advisory subsidiary. The Company's performance obligation in both of these instances is generally satisfied over time, and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and contractually determined fee schedules. Payment is generally received a few days after month end through a direct charge to each customer's account. The Company does not earn performance-based incentives. Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered. Fees generated from transactions executed by the Company's third party broker dealer are remitted by them to the Company on a monthly basis for that month's transactional activity.

Service Charges on Deposit Accounts. Service charges on deposit accounts consist of fees received under depository agreements with customers to provide access to deposited funds, serve as custodian of deposited funds, and when applicable, pay interest on deposits. These service charges primarily include non-sufficient fund fees and other account related service charges. Non-sufficient fund fees are earned when a depositor presents an item for payment in excess of available funds, and the Company, at its discretion, provides the necessary funds to complete the transaction. The Company generates other account related service charge revenue by providing depositors proper safeguard and remittance of funds as well as by delivering optional services for depositors, such as check imaging or treasury management, that are performed upon the depositor's request. The Company's performance obligation for the proper safeguard and remittance of funds, monthly account analysis and any other monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Payment for service charges on deposit accounts is typically received immediately or in the following month through a direct charge to a customer's account.

Interchange Revenue. Interchange revenue includes debit / credit card income and ATM user fees. Card income is primarily comprised of interchange fees earned for standing ready to authorize and providing settlement on card transactions processed through the MasterCard interchange network. The levels and structure of interchange rates are set by MasterCard and can vary based on cardholder purchase volumes. Interchange fees from cardholder transactions represent a percentage of the



underlying transaction value and are recognized daily, concurrently with completion of the Company's performance obligation, the transaction processing services provided to the cardholder. Payment is typically received immediately or in the following month. ATM fees are primarily generated when a Company cardholder withdraws funds from a non-Company ATM or a non-Company cardholder withdraws funds from a Company ATM. The Company satisfies its performance obligation for each transaction at the point in time when the ATM withdrawal is processed.

Other Noninterest Income. The other noninterest income revenue streams within the scope of Topic 606 consist of merchant services revenue, safe deposit box rentals, wire transfer fees, paper statement fees, check printing commissions, other noninterest related fees, and gain on sales of other real estate owned. Revenue from the Company's merchant services business consists principally of transaction and account management fees charged to merchants for the electronic processing of transactions. These fees are net of interchange fees paid to the credit card issuing bank, card company assessments, and revenue sharing amounts. Account management fees are considered earned at the time the merchant's transactions are processed or other services are performed. Fees related to the other components of other noninterest income within the scope of Topic 606 are largely transactional based, and therefore, the Company's performance obligation is satisfied and related revenue recognized, at the point in time the customer uses the selected service to execute a transaction.

NOTE 25 – PARENT COMPANY ONLY FINANCIAL INFORMATION

The following tables present condensed financial information for Midland States Bancorp, Inc. at December 31, 2021 and 2020, and for the years ended December 31, 2021, 2020 and 2019:

| Condensed Balance Sheets <i>(dollars in thousands)</i> | | | |
|------------------------------------------------------------------|-------------------|-------------------|--|
| | December 31, | | |
| | 2021 | 2020 | |
| Assets: | | | |
| Cash | \$ 37,876 | \$ 58,904 | |
| Investment in common stock of subsidiaries | 809,143 | 772,758 | |
| Other assets | 8,094 | 11,317 | |
| Total assets | \$ 855,113 | \$ 842,979 | |
| Liabilities: | | | |
| Subordinated debt | \$ 139,091 | \$ 169,795 | |
| Trust preferred debentures | 49,374 | 48,814 | |
| Other borrowings | 171 | 171 | |
| Other liabilities | 2,640 | 2,808 | |
| Total liabilities | 191,276 | 221,588 | |
| Shareholders' equity | 663,837 | 621,391 | |
| Total liabilities and shareholders' equity | \$ 855,113 | \$ 842,979 | |

Condensed Statements of Income
(*dollars in thousands*)

| | Years ended December 31, | | |
|--------------------------------------------------------------------------------------------|--------------------------|------------------|------------------|
| | 2021 | 2020 | 2019 |
| Dividends from subsidiaries | \$ 45,350 | \$ 89,890 | \$ 43,900 |
| Other income | 932 | — | — |
| Interest expense | 10,668 | 12,054 | 11,798 |
| Other expense | 984 | 1,309 | 2,753 |
| Income before income tax benefit and equity in undistributed income (loss) of subsidiaries | 34,630 | 76,527 | 29,349 |
| Income tax benefit | 2,105 | 2,749 | 3,371 |
| Income before equity in undistributed income (loss) of subsidiaries | 36,735 | 79,276 | 32,720 |
| Equity in undistributed income (loss) of subsidiaries | 44,582 | (56,739) | 23,064 |
| Net income | <u>\$ 81,317</u> | <u>\$ 22,537</u> | <u>\$ 55,784</u> |

Condensed Statements of Cash Flows
(*dollars in thousands*)

| | Years ended December 31, | | |
|-----------------------------------------------------------------------------------|--------------------------|------------------|------------------|
| | 2021 | 2020 | 2019 |
| Cash flows from operating activities: | | | |
| Net income | \$ 81,317 | \$ 22,537 | \$ 55,784 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed (income) loss of subsidiaries | (44,582) | 56,739 | (23,064) |
| Share-based compensation expense | 1,938 | 2,175 | 2,364 |
| Change in other assets | 3,223 | (6,382) | (2,604) |
| Change in other liabilities | 763 | 471 | 1,528 |
| Net cash provided by operating activities | <u>42,659</u> | <u>75,540</u> | <u>34,008</u> |
| Cash flows from investing activities: | | | |
| Net cash paid in acquisition | — | — | (1,021) |
| Net cash received in dissolution of subsidiary | <u>2,003</u> | — | — |
| Net cash provided by (used in) investing activities | <u>2,003</u> | — | (1,021) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of subordinated debt, net of issuance costs | — | — | 98,265 |
| Payments made on subordinated debt | (31,075) | (7,443) | (19,543) |
| Subordinated debt prepayment fees | — | 193 | 1,778 |
| Payments made on other borrowings | — | — | (56,475) |
| Common stock repurchased | (11,692) | (39,615) | (4,019) |
| Redemption of Series G preferred stock | — | (10) | — |
| Redemption of Series H preferred stock | — | — | (2,636) |
| Cash dividends paid on common stock | (25,172) | (24,958) | (23,599) |
| Cash dividends paid on preferred stock | — | — | (191) |
| Proceeds from issuance of common stock under employee benefit plans | <u>2,249</u> | <u>2,524</u> | <u>5,794</u> |
| Net cash used in by financing activities | <u>(65,690)</u> | <u>(69,309)</u> | <u>(626)</u> |
| Net (decrease) increase in cash | <u>(21,028)</u> | <u>6,231</u> | <u>32,361</u> |
| Cash: | | | |
| Beginning of period | \$ 58,904 | \$ 52,673 | \$ 20,312 |
| End of period | <u>\$ 37,876</u> | <u>\$ 58,904</u> | <u>\$ 52,673</u> |

NOTE 26 – SUBSEQUENT EVENTS

On January 25, 2022, the Company announced the signing of a branch purchase and assumption agreement with FNBC whereby Midland has agreed to acquire the deposits and certain loans and other assets associated with FNBC's branches in Mokena and Yorkville, Illinois. Under the terms of the purchase and assumption agreement, Midland expects to acquire approximately \$86 million of deposits and approximately \$26 million of loans. Midland also expects to acquire the Mokena branch location. The transaction is expected to close during the second quarter of 2022, subject to regulatory approval and other customary closing conditions.

ITEM 9 – CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A – CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. The Company's management, including our President and Chief Executive Officer and our Chief Financial Officer, have evaluated the effectiveness of our "disclosure controls and procedures" (as defined in Rule 13a-15(e) under the Exchange Act), as of the end of the period covered by this report. Based on such evaluation, our President and Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective as of that date to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its President and Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management's annual report on internal control over financial reporting. Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation of reliable published financial statements. Internal control over financial reporting includes self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Because of inherent limitations in any system of internal control, no matter how well designed, misstatements due to error or fraud may occur and not be detected, including the possibility of the circumvention or overriding of controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the Company's internal control over financial reporting as of December 31, 2021. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management asserts that the Company maintained effective internal control over financial reporting as of December 31, 2021 based on the specified criteria.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2021, has been audited by Crowe LLP, the independent registered public accounting firm who also has audited the Company's consolidated financial statements included in this Annual Report on Form 10-K. Crowe LLP has issued a report on the Company's internal control over financial reporting as of December 31, 2021, which is included in Item 8 of this Form 10-K and is incorporated into this item by reference.

Changes in internal control over financial reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the fourth fiscal quarter of 2021 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B – OTHER INFORMATION

None.

ITEM 9C – DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

None.

PART III**ITEM 10 – DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this item can be found in the sections titled “Proposal 1 – Election of Directors,” “Delinquent Section 16(a) Reports,” and “Corporate Governance and the Board of Directors” appearing in the Company’s Proxy Statement for the 2022 annual meeting of shareholders to be filed within 120 days after December 31, 2021, which is incorporated herein by reference.

ITEM 11 – EXECUTIVE COMPENSATION

The information required by this item can be found in the sections titled “Compensation Discussion and Analysis,” “Executive Compensation,” “Corporate Governance and the Board of Directors” and “Compensation Committee Report” appearing in the Company’s Proxy Statement for the 2022 annual meeting of shareholders to be filed within 120 days after December 31, 2021, which is incorporated herein by reference.

ITEM 12 – SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Equity Compensation Plans. The following table discloses the number of outstanding options, warrants and rights granted to participants by the Company under our equity compensation plans, as well as the number of securities remaining available for future issuance under these plans as of December 31, 2021. The table provides this information separately for equity compensation plans that have and have not been approved by security holders. Additional information regarding stock incentive plans is presented in Note 18 to the Consolidated Financial Statements included pursuant to Item 8.

| Plan Category | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights ⁽¹⁾ | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|-----------------------------------------------------------------------|----------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by shareholders ⁽²⁾ | 362,052 | \$ 19.77 | 746,798 |
| Equity compensation plans not approved by shareholders ⁽³⁾ | 205,395 | 29.61 | — |
| Total | 567,447 | \$ 21.74 | 746,798 |

(1) The weighted average exercise price only relates to outstanding option awards.

(2) Column (a) includes 259,761 outstanding stock options granted from the initial 1,000,000 shares reserved for issuance under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan, and 102,291 stock units credited to participant accounts under the Deferred Compensation Plan for Directors of Midland States Bancorp, Inc. (Effective November 8, 2018) to be issued in accordance with the director’s election following the director’s separation from service or at a date certain from the Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan. Column (c) reflects 585,887 shares remaining available for issuance under the Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan and 160,911 shares remaining available for issuance under the Amended and Restated Midland States Bancorp, Inc. Employee Stock Purchase Plan (Amended and Restated May 3, 2019).

(3) Column (a) includes 65,033 outstanding stock options granted from the additional 1,000,000 shares reserved for issuance under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan pursuant to the February 2, 2016 amendment and restatement, and 140,362 stock units credited to participant accounts under the Deferred Compensation Plan for Directors of Midland States Bancorp, Inc. (Effective November 8, 2018) to be issued in accordance with the director’s election following the director’s separation from service or at a date certain from the additional 1,000,000 shares reserved for issuance under the Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan pursuant to the February 2, 2016 amendment and restatement.

Other information required by Item 12 can be found in the section titled “Security Ownership of Certain Beneficial Owners” appearing in the Company’s Proxy Statement for the 2022 annual meeting of shareholders to be filed within 120 days after December 31, 2021, which is incorporated herein by reference.

ITEM 13 – CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item can be found in the sections titled “Certain Relationships and Related Party Transactions” and “Corporate Governance and the Board of Directors” appearing in the Company’s Proxy Statement for the 2022 annual meeting of shareholders to be filed within 120 days after December 31, 2021, which is incorporated herein by reference.

ITEM 14 – PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item can be found in the section titled “Proposal 3 – Ratification of the Appointment of Crowe LLP as our Independent Registered Public Accounting Firm” appearing in the Company’s Proxy Statement for the 2022 annual meeting of shareholders to be filed within 120 days after December 31, 2021, which is incorporated herein by reference.

PART IV

ITEM 15 – EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

- (a) The following documents are filed as part of this report:

(1) Financial Statements:

The following consolidated financial statements of the registrant and its subsidiaries are filed as part of this document under Item 8 - "Financial Statements and Supplementary Data."

Consolidated Balance Sheets – December 31, 2021 and 2020

Consolidated Statements of Income – Years Ended December 31, 2021, 2020 and 2019

Consolidated Statements of Comprehensive Income – Years Ended December 31, 2021, 2020 and 2019

Consolidated Statements of Shareholders' Equity – Years Ended December 31, 2021, 2020 and 2019

Consolidated Statements of Cash Flows – Years Ended December 31, 2021, 2020 and 2019

Notes to Consolidated Financial Statements

(2) Financial Statement Schedules:

All schedules are omitted as such information is inapplicable or is included in the financial statements.

(3) Exhibits:

The exhibits are filed as part of this report and exhibits incorporated herein by reference to other documents are as follows:

| Exhibit No. | Description |
|-------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1 | <u>Articles of Incorporation of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u> |
| 3.2 | <u>Articles of Amendment to the Articles of Incorporation of Midland States Bancorp, Inc., effective May 8, 2018 (incorporated by reference to Exhibit 3.5 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 8, 2018).</u> |
| 3.3 | <u>Statement of Resolution Establishing Series of Series G Preferred Stock of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on June 12, 2017).</u> |
| 3.4 | <u>By-laws of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u> |
| 4.1 | <u>Specimen common stock certificate of Midland States Bancorp, Inc. (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u> |
| 4.2 | <u>Description of the Company's Securities Registered Pursuant to Section 12 of the Securities Exchange Act of 1934 (incorporated by reference to Exhibit 4.2 to the Company's Annual Report on Form 10-K filed with the SEC on February 28, 2020).</u> |
| 4.3 | <u>Indenture, dated as of September 20, 2019, between Midland States Bancorp, Inc. and UMB Bank National Association, as trustee, regarding 5.00% Fixed-to-Floating Rate Subordinated Notes due 2029 (incorporated herein by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K filed with the SEC on September 20, 2019).</u> |

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|-------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.4 | Form of 5.00% Fixed-to-Floating Rate Subordinated Notes due 2029 (included in Exhibit 4.3). |
| 4.5 | <u>Indenture, dated as of September 20, 2019, between Midland States Bancorp, Inc. and UMB Bank National Association, as trustee, regarding 5.50% Fixed-to-Floating Rate Subordinated Notes due 2034 (incorporated herein by reference to Exhibit 4.3 of the Company's Current Report on Form 8-K filed with the SEC on September 20, 2019).</u> |
| 4.6 | Form of 5.50% Fixed-to-Floating Rate Subordinated Notes due 2034 (included in Exhibit 4.5). |
| 10.1* | <u>Amended and Restated Employment Agreement, dated as of November 5, 2020, between Midland States Bancorp, Inc., Midland States Bank and Jeffrey Ludwig (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K filed with the SEC on February 26, 2021).</u> |
| 10.2* | <u>Amended and Restated Employment Agreement, dated as of November 5, 2020, between Midland States Bancorp, Inc., Midland States Bank and Jeffrey Mefford incorporated by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K filed with the SEC on February 26, 2021).</u> |
| 10.3* | <u>Amended and Restated Employment Agreement, dated as of November 5, 2020, between Midland States Bancorp, Inc., Midland States Bank and Douglas J. Tucker incorporated by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-K filed with the SEC on February 26, 2021).</u> |
| 10.4* | <u>Amended and Restated Employment Agreement, dated as of November 5, 2020, between Midland States Bancorp, Inc., Midland States Bank and Eric T. Lemke incorporated by reference to Exhibit 10.7 to the Company's Annual Report on Form 10-K filed with the SEC on February 26, 2021).</u> |
| 10.5* | <u>Amended and Restated Employment Agreement, dated as of November 5, 2020, between Midland States Bank and Jeff Brunoehler incorporated by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K filed with the SEC on February 26, 2021).</u> |
| 10.6* | <u>Amended and Restated Employment Agreement, dated as of November 5, 2020, between Midland States Bank and James R. Stewart incorporated by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K filed with the SEC on February 26, 2021).</u> |
| 10.7* | <u>Midland States Bancorp, Inc. Second Amended and Restated 2010 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.10 to Pre-Effective Amendment No. 2 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on May 11, 2016).</u> |
| 10.8* | <u>Deferred Compensation Plan for Directors of Midland States Bancorp, Inc. (Effective November 8, 2018) (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K filed with the SEC on February 28, 2019).</u> |
| 10.9* | <u>Deferred Compensation Plan for Executives of Midland States Bancorp, Inc. (Effective November 8, 2018) (incorporated by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K filed with the SEC on February 28, 2019).</u> |

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| | |
|--------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.10* | <u>Amended and Restated Midland States Bancorp, Inc. Employee Stock Purchase Plan (Amended and Restated May 3, 2019) (incorporated by reference to Exhibit 4.11 to the Company's Registration Statement on Form S-8 (File No. 333-231323), filed with the SEC on May 9, 2019).</u> |
| 10.11* | <u>Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.6 to the Company's Registration Statement on Form S-8 (File No. 333-231323), filed with the SEC on May 9, 2019).</u> |
| 10.12* | <u>Form of Incentive Stock Option Award Agreement under the Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.7 to the Company's Registration Statement on Form S-8 (File No. 333-231323), filed with the SEC on May 9, 2019).</u> |
| 10.13* | <u>Form of Nonqualified Stock Option Award Agreement under the Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.8 to the Company's Registration Statement on Form S-8 (File No. 333-231323), filed with the SEC on May 9, 2019).</u> |
| 10.14* | <u>Form of Restricted Stock Unit Award Agreement under the Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.9 to the Company's Registration Statement on Form S-8 (File No. 333-231323), filed with the SEC on May 9, 2019).</u> |
| 10.15* | <u>Form of Restricted Stock Award Agreement under the Midland States Bancorp, Inc. 2019 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.10 to the Company's Registration Statement on Form S-8 (File No. 333-231323), filed with the SEC on May 9, 2019).</u> |
| 10.16* | <u>Midland States Bancorp, Inc. Omnibus Stock Ownership and Long Term Incentive Plan (incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-1 (File No. 333-210683), filed with the SEC on April 11, 2016).</u> |
| 21.1 | <u>Subsidiaries of Midland States Bancorp, Inc. – filed herewith.</u> |
| 23.1 | <u>Consent of Crowe LLP – filed herewith.</u> |
| 31.1 | <u>Principal Executive Officer's Certification required by Rule 13(a)-14(a) – filed herewith.</u> |
| 31.2 | <u>Principal Financial Officer's Certification required by Rule 13(a)-14(a) – filed herewith.</u> |
| 32.1 | <u>Principal Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.</u> |
| 32.2 | <u>Principal Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.</u> |

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| 101.INS | The Inline XBRL Instance Document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document. |
| 101.SCH | Inline XBRL Taxonomy Extension Schema Document – filed herewith. |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document– filed herewith. |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document– filed herewith. |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase Document– filed herewith. |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase Document– filed herewith. |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase Document– filed herewith. |
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101). |

* Management contract or compensatory plan or arrangement

ITEM 16 – FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MIDLAND STATES BANCORP, INC.

Date: February 25, 2022

By: /s/ Jeffrey G. Ludwig

Jeffrey G. Ludwig

President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signatures | Title | Date |
|---------------------------------------------------------|------------------------------------------------------------------------------------------|-------------------|
| <u>/s/ Jeffrey C. Smith</u> Jeffrey C. Smith | Chairman of the Board of Directors | February 25, 2022 |
| <u>/s/ Jeffrey G. Ludwig</u> Jeffrey G. Ludwig | President, Chief Executive Officer and Vice Chairman (Principal Executive Officer) | February 25, 2022 |
| <u>/s/ Eric T. Lemke</u> Eric T. Lemke | Chief Financial Officer (Principal Financial Officer) | February 25, 2022 |
| <u>/s/ Donald J. Spring</u> Donald J. Spring | Chief Accounting Officer (Principal Accounting Officer) | February 25, 2022 |
| <u>/s/ R. Dean. Bingham</u> R. Dean. Bingham | Director | February 25, 2022 |
| <u>/s/ Jennifer L. DiMotta</u> Jennifer L. DiMotta | Director | February 25, 2022 |
| <u>/s/ Deborah A. Golden</u> Deborah A. Golden | Director | February 25, 2022 |
| <u>/s/ Jerry L. McDaniel</u> Jerry L. McDaniel | Director | February 25, 2022 |
| <u>/s/ Jeffrey M. McDonnell</u> Jeffrey M. McDonnell | Director | February 25, 2022 |
| <u>/s/ Dwight A. Miller</u> Dwight A. Miller | Director | February 25, 2022 |
| <u>/s/ Richard T. Ramos</u> Richard T. Ramos | Director | February 25, 2022 |
| <u>/s/ Robert F. Schultz</u> Robert F. Schultz | Director | February 25, 2022 |