

OLD NATIONAL BANCORP /IN/

Form 10-Q

November 02, 2012

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2012

.. **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 1-15817

**OLD NATIONAL BANCORP**

(Exact name of Registrant as specified in its charter)

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

**INDIANA**  
(State or other jurisdiction of  
incorporation or organization)

**35-1539838**  
(I.R.S. Employer  
Identification No.)

**One Main Street**  
**Evansville, Indiana**  
(Address of principal executive offices)

**47708**  
(Zip Code)

**(812) 464-1294**

(Registrant's telephone number, including area code)

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 the filing requirements for at least the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (s232.405 of this chapter) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock. The Registrant has one class of common stock (no par value) with 101,403,000 shares outstanding at September 30, 2012.

**Table of Contents**

**OLD NATIONAL BANCORP**

**FORM 10-Q**

**INDEX**

	Page No.
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. Financial Statements	
<u>Consolidated Balance Sheets September 30, 2012 (unaudited), December 31, 2011 and September 30, 2011 (unaudited)</u>	3
<u>Consolidated Statements of Income (unaudited) Three and nine months ended September 30, 2012 and 2011</u>	4
<u>Consolidated Statements of Comprehensive Income (unaudited) Three and nine months ended September 30, 2012 and 2011</u>	5
<u>Consolidated Statements of Changes in Shareholders' Equity (unaudited) Nine months ended September 30, 2012 and 2011</u>	6
<u>Consolidated Statements of Cash Flows (unaudited) Nine months ended September 30, 2012 and 2011</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	62
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	89
<u>Item 4. Controls and Procedures</u>	89
<b><u>PART II OTHER INFORMATION</u></b>	90
<b><u>SIGNATURES</u></b>	97

**Table of Contents****OLD NATIONAL BANCORP****CONSOLIDATED BALANCE SHEETS**

(dollars and shares in thousands, except per share data)	September 30, 2012 (unaudited)	December 31, 2011	September 30, 2011 (unaudited)
<b>Assets</b>			
Cash and due from banks	\$ 180,490	\$ 191,626	\$ 194,606
Money market and other interest-earning investments	37,043	31,246	74,623
Total cash and cash equivalents	217,533	222,872	269,229
Trading securities at fair value	3,043	2,816	2,794
Investment securities available-for-sale, at fair value			
U.S. Treasury	15,585	65,769	65,951
U.S. Government-sponsored entities and agencies	387,176	173,185	180,934
Mortgage-backed securities	1,172,671	1,268,155	1,441,585
States and political subdivisions	557,835	402,844	391,202
Other securities	179,522	161,323	173,417
Total investment securities available-for-sale	2,312,789	2,071,276	2,253,089
Investment securities held-to-maturity, at amortized cost (fair value \$440,014, \$507,699 and \$517,427 respectively)	410,521	484,590	493,282
Federal Home Loan Bank stock, at cost	37,927	30,835	34,870
Residential loans held for sale, at fair value	9,911	4,528	4,710
Loans:			
Commercial	1,294,015	1,216,654	1,246,289
Commercial real estate	1,291,054	1,067,370	1,128,374
Residential real estate	1,279,238	995,458	865,951
Consumer credit, net of unearned income	930,070	861,361	899,446
Covered loans, net of discount	448,789	626,360	711,266
Total loans	5,243,166	4,767,203	4,851,326
Allowance for loan losses	(50,428)	(57,117)	(65,219)
Allowance for loan losses covered loans	(4,334)	(943)	(303)
Net loans	5,188,404	4,709,143	4,785,804
FDIC indemnification asset	126,881	167,714	168,483
Premises and equipment, net	83,259	71,870	75,257
Accrued interest receivable	46,430	44,801	43,713
Goodwill	339,883	253,177	265,985
Other intangible assets	31,273	33,624	36,298
Company-owned life insurance	268,919	248,693	247,234
Assets held for sale	15,508	16,861	
Other real estate owned and repossessed personal property	14,282	7,119	9,390
Other real estate owned covered	28,780	30,443	31,908
Other assets	247,701	209,321	210,654
Total assets	\$ 9,383,044	\$ 8,609,683	\$ 8,932,700
<b>Liabilities</b>			
Deposits:			
Noninterest-bearing demand	\$ 1,943,525	\$ 1,728,546	\$ 1,728,548

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Interest-bearing:			
NOW	<b>1,694,792</b>	1,569,084	1,517,117
Savings	<b>1,939,665</b>	1,570,422	1,624,786
Money market	<b>282,308</b>	295,847	306,089
Time	<b>1,361,087</b>	1,447,664	1,690,723
<b>Total deposits</b>	<b>7,221,377</b>	6,611,563	6,867,263
Short-term borrowings	<b>452,060</b>	424,849	341,004
Other borrowings	<b>288,502</b>	290,774	443,884
Accrued expenses and other liabilities	<b>234,341</b>	248,941	252,854
<b>Total liabilities</b>	<b>8,196,280</b>	7,576,127	7,905,005
<b>Shareholders Equity</b>			
Preferred stock, series A, 1,000 shares authorized, no shares issued or outstanding			
Common stock, \$1 stated value, 150,000 shares authorized, 101,403, 94,654 and 94,752 shares issued and outstanding, respectively	<b>101,403</b>	94,654	94,752
Capital surplus	<b>918,259</b>	834,033	834,060
Retained earnings	<b>132,822</b>	89,865	74,312
Accumulated other comprehensive income, net of tax	<b>34,280</b>	15,004	24,571
<b>Total shareholders equity</b>	<b>1,186,764</b>	1,033,556	1,027,695
<b>Total liabilities and shareholders equity</b>	<b>\$ 9,383,044</b>	\$ 8,609,683	\$ 8,932,700

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

**Table of Contents****OLD NATIONAL BANCORP****CONSOLIDATED STATEMENTS OF INCOME (unaudited)**

(dollars and shares in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>Interest Income</b>				
Loans including fees:				
Taxable	<b>\$ 60,916</b>	\$ 62,706	<b>\$ 185,957</b>	\$ 165,058
Nontaxable	<b>2,192</b>	2,361	<b>6,639</b>	7,018
Investment securities, available-for-sale:				
Taxable	<b>10,810</b>	13,197	<b>33,470</b>	39,730
Nontaxable	<b>3,997</b>	3,331	<b>11,482</b>	10,172
Investment securities, held-to-maturity, taxable	<b>4,839</b>	5,487	<b>14,708</b>	18,039
Money market and other interest-earning investments	<b>18</b>	87	<b>43</b>	341
<b>Total interest income</b>	<b>82,772</b>	87,169	<b>252,299</b>	240,358
<b>Interest Expense</b>				
Deposits	<b>6,419</b>	9,401	<b>21,145</b>	28,989
Short-term borrowings	<b>124</b>	132	<b>369</b>	390
Other borrowings	<b>2,079</b>	5,044	<b>6,389</b>	14,701
<b>Total interest expense</b>	<b>8,622</b>	14,577	<b>27,903</b>	44,080
<b>Net interest income</b>	<b>74,150</b>	72,592	<b>224,396</b>	196,278
Provision for loan losses	<b>400</b>	(82)	<b>2,849</b>	6,437
<b>Net interest income after provision for loan losses</b>	<b>73,750</b>	72,674	<b>221,547</b>	189,841
<b>Noninterest Income</b>				
Wealth management fees	<b>5,198</b>	5,094	<b>16,138</b>	15,521
Service charges on deposit accounts	<b>12,816</b>	14,048	<b>38,582</b>	38,062
ATM fees	<b>5,692</b>	6,766	<b>17,920</b>	18,736
Mortgage banking revenue	<b>840</b>	699	<b>2,172</b>	2,560
Insurance premiums and commissions	<b>8,670</b>	8,335	<b>27,595</b>	27,916
Investment product fees	<b>3,359</b>	2,977	<b>9,453</b>	8,504
Company-owned life insurance	<b>1,734</b>	1,393	<b>4,741</b>	3,863
Net securities gains	<b>2,877</b>	2,861	<b>10,488</b>	5,026
Total other-than-temporary impairment losses	<b>(202)</b>	(140)	<b>(1,078)</b>	(1,872)
Loss recognized in other comprehensive income		140		1,373
Impairment losses recognized in earnings	<b>(202)</b>		<b>(1,078)</b>	(499)
Gain on derivatives	<b>226</b>	149	<b>657</b>	702
Gain on sale leaseback transactions	<b>1,607</b>	1,636	<b>4,820</b>	4,909
Change in FDIC indemnification asset	<b>(4,877)</b>	535	<b>(4,118)</b>	535
Other income	<b>2,927</b>	2,833	<b>11,172</b>	7,901
<b>Total noninterest income</b>	<b>40,867</b>	47,326	<b>138,542</b>	133,736
<b>Noninterest Expense</b>				
Salaries and employee benefits	<b>49,876</b>	52,325	<b>142,673</b>	139,930
Occupancy	<b>13,454</b>	13,328	<b>39,170</b>	37,826

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Equipment	<b>2,902</b>	2,878	<b>8,725</b>	8,720
Marketing	<b>1,537</b>	1,294	<b>4,474</b>	4,193
Data processing	<b>5,432</b>	5,703	<b>16,835</b>	17,538
Communication	<b>2,627</b>	2,529	<b>8,053</b>	7,507
Professional fees	<b>3,787</b>	5,905	<b>9,141</b>	10,462
Loan expense	<b>1,760</b>	1,139	<b>4,896</b>	3,351
Supplies	<b>739</b>	646	<b>2,106</b>	2,191
FDIC assessment	<b>1,320</b>	1,657	<b>4,094</b>	5,621
Other real estate owned expense	<b>371</b>	580	<b>11,754</b>	1,682
Amortization of intangibles	<b>1,956</b>	2,106	<b>5,888</b>	5,868
Other expense	<b>3,258</b>	5,068	<b>8,524</b>	9,952
Total noninterest expense	<b>89,019</b>	95,158	<b>266,333</b>	254,841
Income before income taxes	<b>25,598</b>	24,842	<b>93,756</b>	68,736
Income tax expense	<b>5,861</b>	8,045	<b>25,090</b>	18,490
Net income	<b>\$ 19,737</b>	\$ 16,797	<b>\$ 68,666</b>	\$ 50,246
Net income per common share basic	<b>\$ 0.20</b>	\$ 0.18	<b>\$ 0.72</b>	\$ 0.53
Net income per common share diluted	<b>0.20</b>	0.18	<b>0.72</b>	0.53
Weighted average number of common shares outstanding-basic	<b>95,690</b>	94,492	<b>94,886</b>	94,468
Weighted average number of common shares outstanding-diluted	<b>96,125</b>	94,785	<b>95,274</b>	94,722
Dividends per common share	<b>\$ 0.09</b>	\$ 0.07	<b>\$ 0.27</b>	\$ 0.21

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

**Table of Contents****OLD NATIONAL BANCORP****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)**

(dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	<b>\$ 19,737</b>	\$ 16,797	<b>\$ 68,666</b>	\$ 50,246
Other comprehensive income				
Change in securities available-for-sale:				
Unrealized holding gains for the period	<b>23,002</b>	16,032	<b>40,463</b>	47,324
Reclassification adjustment for securities gains realized in income	<b>(2,877)</b>	(2,861)	<b>(10,488)</b>	(5,026)
Other-than-temporary-impairment on available-for-sale securities recorded in other comprehensive income		(140)		(1,373)
Other-than-temporary-impairment on available-for-sale securities associated with credit loss realized in income	<b>202</b>		<b>1,078</b>	499
Income tax effect	<b>(7,901)</b>	(5,149)	<b>(12,076)</b>	(16,202)
Unrealized gains on available-for-sale securities	<b>12,426</b>	7,882	<b>18,977</b>	25,222
Change in securities held-to-maturity:				
Adjustment for securities transferred to available-for-sale	<b>(1,588)</b>		<b>(1,588)</b>	
Amortization of fair value for securities held-to-maturity previously recognized into accumulated other comprehensive income	<b>(232)</b>	(337)	<b>(693)</b>	(1,304)
Income tax effect	<b>729</b>	134	<b>913</b>	521
Changes from securities held-to-maturity	<b>(1,091)</b>	(203)	<b>(1,368)</b>	(783)
Cash flow hedges:				
Net unrealized derivative gains (losses) on cash flow hedges		(412)	<b>(240)</b>	(1,021)
Reclassification adjustment on cash flow hedges		72		216
Income tax effect	<b>(1)</b>	137	<b>95</b>	324
Changes from cash flow hedges	<b>(1)</b>	(203)	<b>(145)</b>	(481)
Defined benefit pension plans:				
Amortization of net loss recognized in income	<b>1,007</b>	1,154	<b>3,021</b>	3,137
Income tax effect	<b>(403)</b>	(461)	<b>(1,209)</b>	(1,255)
Changes from defined benefit pension plans	<b>604</b>	693	<b>1,812</b>	1,882
Other comprehensive income, net of tax	<b>11,938</b>	8,169	<b>19,276</b>	25,840
Comprehensive income	<b>\$ 31,675</b>	\$ 24,966	<b>\$ 87,942</b>	\$ 76,086

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



**Table of Contents****OLD NATIONAL BANCORP****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (unaudited)**

(dollars and shares in thousands)	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
<b>Balance, December 31, 2010</b>	\$ 87,183	\$ 748,873	\$ 44,018	\$ (1,269)	\$ 878,805
Comprehensive income					
Net income			50,246		50,246
Other comprehensive income					
Change in unrealized gain (loss) on securities available for sale, net of reclassification and tax				25,222	25,222
Transferred securities, net of tax				(783)	(783)
Reclassification adjustment on cash flows hedges, net of tax				(481)	(481)
Net loss, settlement cost and amortization of net (gain) loss on defined benefit pension plans, net of tax				1,882	1,882
Acquisition Monroe Bancorp	7,575	82,495			90,070
Dividends common stock			(19,889)		(19,889)
Common stock issued	15	151			166
Common stock repurchased	(33)	(308)			(341)
Stock based compensation expense		2,551			2,551
Stock activity under incentive comp plans	12	298	(63)		247
<b>Balance, September 30, 2011</b>	\$ 94,752	\$ 834,060	\$ 74,312	\$ 24,571	\$ 1,027,695
<b>Balance, December 31, 2011</b>	\$ 94,654	\$ 834,033	\$ 89,865	\$ 15,004	\$ 1,033,556
Comprehensive income					
Net income			68,666		68,666
Other comprehensive income					
Change in unrealized gain (loss) on securities available for sale, net of reclassification and tax				18,977	18,977
Transferred securities, net of tax				(1,368)	(1,368)
Reclassification adjustment on cash flows hedges, net of tax				(145)	(145)
Net loss, settlement cost and amortization of net (gain) loss on defined benefit pension plans, net of tax				1,812	1,812
Acquisition Indiana Community Bancorp	6,626	81,871			88,497
Dividends common stock			(25,551)		(25,551)
Common stock issued	16	171			187
Common stock repurchased	(66)	(765)			(831)
Stock based compensation expense		2,203			2,203
Stock activity under incentive comp plans	173	746	(158)		761
<b>Balance, September 30, 2012</b>	\$ 101,403	\$ 918,259	\$ 132,822	\$ 34,280	\$ 1,186,764

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

**Table of Contents****OLD NATIONAL BANCORP****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

(dollars in thousands)	Nine Months Ended September 30,	
	2012	2011
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 68,666	\$ 50,246
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	8,618	7,269
Amortization and impairment of other intangible assets	5,888	5,868
Net premium amortization on investment securities	9,546	8,060
(Accretion) amortization of FDIC indemnification asset	4,118	(535)
Stock compensation expense	2,203	2,551
Provision for loan losses	2,849	6,437
Net securities gains	(10,488)	(5,026)
Impairment on available-for-sale securities	1,078	499
Gain on sale leasebacks	(4,820)	(4,909)
Gain on derivatives	(657)	(702)
Net (gains) losses on sales and write-downs of loans and other assets	303	(1,459)
Increase in cash surrender value of company owned life insurance	(4,393)	(3,836)
Residential real estate loans originated for sale	(51,833)	(70,232)
Proceeds from sale of residential real estate loans	49,465	79,089
Decrease in interest receivable	536	5,812
Decrease in other real estate owned	670	7,420
Decrease in other assets	1,732	9,800
Increase (decrease) in accrued expenses and other liabilities	(25,493)	15,838
Total adjustments	(10,678)	61,944
Net cash flows provided by operating activities	57,988	112,190
<b>Cash Flows From Investing Activities</b>		
Cash and cash equivalents of acquired banks	78,538	398,558
Net cash paid in FDIC-assisted transaction		(151,264)
Purchases of investment securities available-for-sale	(687,698)	(490,086)
Purchase of trust assets		(1,301)
Proceeds from the call/repurchase of FHLB stock		14,587
Proceeds from maturities, prepayments and calls of investment securities available-for-sale	478,218	379,727
Proceeds from sales of investment securities available-for-sale	192,020	454,110
Proceeds from maturities, prepayments and calls of investment securities held-to-maturity	24,851	147,050
Proceeds from sale of loans	2,292	4,743
Reimbursements under FDIC loss share agreements	36,338	
Net principal collected from loan customers	9,123	105,354
Proceeds from sale of premises and equipment and other assets	3,434	413
Purchases of premises and equipment and other assets	(9,368)	(4,184)
Net cash flows provided by investing activities	127,748	857,707
<b>Cash Flows From Financing Activities</b>		
Net increase (decrease) in deposits and short-term borrowings:		
Deposits	(175,239)	(692,932)

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Short-term borrowings	27,210	(27,411)
Payments for maturities on other borrowings	(1,416)	(725)
Payments related to retirement of debt	(16,000)	(211,228)
Cash dividends paid on common stock	(25,551)	(19,889)
Common stock repurchased	(831)	(341)
Proceeds from exercise of stock options, including tax benefit	565	140
Common stock issued	187	166
<b>Net cash flows used in financing activities</b>	<b>(191,075)</b>	<b>(952,220)</b>
Net increase in cash and cash equivalents	(5,339)	17,677
Cash and cash equivalents at beginning of period	222,872	251,552
<b>Cash and cash equivalents at end of period</b>	<b>\$ 217,533</b>	<b>\$ 269,229</b>
<b>Supplemental cash flow information:</b>		
Total interest paid	\$ 30,264	\$ 44,814
Total taxes paid (net of refunds)	\$ 20,969	\$ 4,605
Securities transferred from held-to-maturity to available-for-sale	\$ 46,053	\$

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

---

**Table of Contents****OLD NATIONAL BANCORP****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)****NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements include the accounts of Old National Bancorp and its wholly-owned affiliates (hereinafter collectively referred to as Old National ) and have been prepared in conformity with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. Such principles require management to make estimates and assumptions that affect the reported amounts of assets, liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The allowance for loan losses, valuation of purchased loans, valuation and impairment of securities, goodwill and intangibles, derivative financial instruments, and income taxes are particularly subject to change. In the opinion of management, the consolidated financial statements contain all the normal and recurring adjustments necessary for a fair statement of the financial position of Old National as of September 30, 2012 and 2011, and December 31, 2011, and the results of its operations for the three and nine months ended September 30, 2012 and 2011. Interim results do not necessarily represent annual results. These financial statements should be read in conjunction with Old National's Annual Report for the year ended December 31, 2011.

All significant intercompany transactions and balances have been eliminated. Certain prior year amounts have been reclassified to conform with the 2012 presentation. Such reclassifications had no effect on net income or shareholders' equity.

**NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS**

**FASB ASC 820** In May 2011, the FASB issued an update (ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs) impacting FASB ASC 820, Fair Value Measurement. The amendments in this update will improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards (IFRSs). Among the many areas affected by this update are the concept of highest and best use, the fair value of an instrument included in shareholders' equity and disclosures about fair value measurement, especially disclosures about fair value measurements categorized within Level 3 of the fair value hierarchy. This update became effective for the Company for interim and annual reporting periods beginning after December 15, 2011 and did not have a material impact on the consolidated financial statements.

**FASB ASC 220** In June 2011, the FASB issued an update (ASU No. 2011-05, Presentation of Comprehensive Income) impacting FASB ASC 220, Comprehensive Income. The amendments in this update eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. An entity will have the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. An entity will be required to present on the face of financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income. This update and ASC No. 2011-12, which defers a portion of this guidance, became effective for the Company for interim and annual reporting periods beginning after December 15, 2011 and did not have a material impact on the consolidated financial statements.

**FASB ASC 350** In September 2011, the FASB issued an update (ASU No. 2011-08, Testing Goodwill for Impairment) impacting FASB ASC 350-20, Intangibles—Goodwill and Other. The amendments in this update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than the carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more likely than not threshold is defined as having a likelihood of more than 50 percent. If after assessing the totality of events or circumstances, it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. If an entity concludes that it is more likely than not that the fair value of the reporting unit is less than the carrying amount, the entity is required to perform the first step of the two-step impairment. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss. This update became effective for the Company for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company has performed an analysis under this approach and it did not have a material impact on the consolidated financial statements.

## **Table of Contents**

**FASB ASC 360** In December 2011, the FASB issued an update (ASU No. 2011-10, Derecognition of in Substance Real Estate – a Scope Clarification) impacting FASB ASC 360-20, Property, Plant, and Equipment – Real Estate Sales. Under the amendments in this update, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary’s nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related nonrecourse debt. This update became effective for the Company for interim and annual reporting periods beginning on or after June 15, 2012. The Company does not expect this guidance to have a material impact on the consolidated financial statements.

**FASB ASC 220** In December 2011, the FASB issued an update (ASU No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05) impacting FASB ASC 220, Comprehensive Income. This update defers the requirement to present items that are reclassified from accumulated other comprehensive income to net income in both the statement where net income is presented and the statement where other comprehensive income is presented. An entity should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05. This update became effective for the Company for interim and annual reporting periods beginning after December 15, 2011 and did not have a material impact on the consolidated financial statements.

**FASB ASC 805** In October 2012, the FASB issued an update (ASU No. 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution) impacting FASB ASC 805, Business Combinations. This update specifies that when an entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs, the entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets). This update becomes effective for interim and annual periods beginning on or after December 15, 2012, and is consistent with the Company’s current accounting treatment of changes in expected cash flows and the indemnification asset and will not have a material impact on the consolidated financial statements.

## **NOTE 3 ACQUISITION AND DIVESTITURE ACTIVITY**

### **Indiana Community Bancorp**

On September 15, 2012, Old National acquired 100 % of Indiana Community Bancorp ( IBT ) in an all stock transaction. IBT was headquartered in Columbus, Indiana and had 17 full-service banking centers serving the South Central Indiana area. The acquisition increases Old National’s position as the third largest branch network in Indiana. Pursuant to the merger agreement, the shareholders of IBT received approximately 6.6 million shares of Old National Bancorp stock valued at approximately \$88.5 million.

**Table of Contents**

Under the acquisition method of accounting, the total estimated purchase price is allocated to IBT's net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on management's preliminary valuation of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the IBT acquisition is allocated as follows (in thousands):

Cash and cash equivalents	\$ 78,538
Investment securities	154,802
Loans	496,167
Premises and equipment	13,465
Accrued interest receivable	2,165
Other real estate owned	6,170
Company-owned life insurance	15,833
Other assets	49,974
Deposits	(784,589)
Other borrowings	(15,464)
Accrued expenses and other liabilities	(18,296)
Net tangible assets acquired	(1,235)
Definite-lived intangible assets acquired	3,024
Goodwill	86,708
Purchase price	\$ 88,497

Prior to the end of the one year measurement period for finalizing the purchase price allocation, if information becomes available which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

Of the total purchase price, \$1.2 million has been allocated to net tangible liabilities acquired and \$3.0 million has been allocated to definite-lived intangible assets acquired. The remaining purchase price has been allocated to goodwill. The goodwill will not be deductible for tax purposes and is included in the Community Banking and Other segments, as described in Note 20 of these consolidated financial statement footnotes.

The components of the estimated fair value of the acquired identifiable intangible assets are in the table below. These intangible assets will be amortized on an accelerated basis over their estimated lives and are included in the Community Banking and Other segments, as described in Note 20 of these consolidated financial statement footnotes.

	Estimated Fair Value (in millions)	Estimated Useful Lives (Years)
Core deposit intangible	\$ 1.3	7
Trust customer relationship intangible	\$ 1.7	12

**Integra Bank N.A.**

On July 29, 2011, Old National acquired the banking operations of Integra Bank N.A. in an FDIC assisted transaction. As part of the purchase and assumption agreement, the Company and the FDIC entered into loss sharing agreements whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded commitments), other real estate owned and up to 90 days of certain accrued interest on loans. The acquired loans and OREO subject to the loss sharing agreements are referred to collectively as covered assets. Under the terms of the loss sharing agreements, the FDIC will reimburse Old National for 80% of losses up to \$275.0 million, losses in excess of \$275.0 million up to \$467.2 million at 0% reimbursement, and 80% of losses in excess of \$467.2 million. Old National will reimburse the FDIC for its share of recoveries with respect to losses for which the FDIC has reimbursed the Bank under the loss sharing agreements. The loss sharing provisions of the agreements for commercial and single family residential mortgage loans are in effect for five and ten years, respectively, from the July 29, 2011 acquisition date and the loss recovery provisions for such loans are in effect for eight years and ten years, respectively, from the acquisition

date.

**Table of Contents**

Integra was a full service community bank headquartered in Evansville, Indiana that operated 52 branch locations. We entered into this transaction due to the attractiveness in the pricing of the acquired loan portfolio, including the indemnification assets, and the attractiveness of immediate low cost core deposits. We also believed there were opportunities to enhance income and improve efficiencies. We believe participating with the FDIC in this assisted transaction was advantageous to the Company.

The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the July 29, 2011 acquisition date. The application of the acquisition method of accounting resulted in the recognition of \$16.9 million of goodwill and \$4.3 million of core deposit intangible, after tax. The goodwill represents the excess of the estimated fair value of the liabilities assumed over the estimated fair value of the assets acquired and is influenced significantly by the FDIC-assisted transaction process. Goodwill of \$29.0 million is deductible for income tax purposes.

Due primarily to the significant amount of fair value adjustments and the FDIC loss sharing agreements put in place, historical results for Integra are not meaningful to the Company's results and thus no pro forma information is presented.

Under the acquisition method of accounting, the total purchase price is allocated to Integra's net tangible and intangible assets based on their current estimated fair values on the date of acquisition. The purchase price of \$170.8 million was allocated as follows:

(dollars in thousands)

<b>Assets Acquired</b>	
Cash and cash equivalents	\$ 314,954
Investment securities available for sale	453,700
Federal Home Loan Bank stock, at cost	15,226
Residential loans held for sale	1,690
Loans covered	727,330
Loans non-covered	56,828
Premises and equipment	19,713
Other real estate owned	34,055
Accrued interest receivable	4,751
Goodwill	16,864
Other intangible assets	4,291
FDIC indemnification asset	167,949
Other assets	9,999
<b>Assets acquired</b>	<b>\$ 1,827,350</b>
<b>Liabilities Assumed</b>	
Deposits	\$ 1,443,209
Short-term borrowings	7,654
Other borrowings	192,895
FDIC settlement payable	170,759
Other liabilities	12,833
<b>Liabilities assumed</b>	<b>\$ 1,827,350</b>



**Table of Contents****Divestiture**

On December 2, 2011, Old National sold \$106.9 million of deposits from four of the former Integra Bank branches located in the Chicago area to First Midwest Bank. Old National recorded a net gain of \$0.5 million after recording the \$0.4 million deposit premium plus \$0.8 million related to the time deposit premium less \$0.7 million of accelerated amortization associated with the core deposit intangible. Old National retained all of the loans.

**Trust Business of Integra Bank**

On June 1, 2011, Old National Bancorp's wholly owned trust subsidiary, American National Trust and Investment Management Company d/b/a Old National Trust Company ( ONTC ), acquired the trust business of Integra Bank, N.A. in a transaction unrelated to the previously noted FDIC transaction. As of the closing, the trust business had approximately \$328 million in assets under management. This transaction brings the total assets under management by Old National's Wealth Management division to approximately \$4.4 billion. Old National paid Integra \$1.3 million in an all cash transaction and recorded acquisition-related costs of \$126 thousand. Old National recorded \$1.3 million of customer relationship intangible assets which will be amortized on an accelerated basis over 12 years and is included in the Other segment, as described in Note 20 of the consolidated financial statement footnotes.

**Monroe Bancorp**

On January 1, 2011, Old National acquired 100 % of Monroe Bancorp ( Monroe ) in an all stock transaction. Monroe was headquartered in Bloomington, Indiana and had 15 banking centers. The acquisition increases Old National's market position to number 1 in Bloomington and strengthens its position as the third largest branch network in Indiana. Pursuant to the merger agreement, the shareholders of Monroe received approximately 7.6 million shares of Old National Bancorp stock valued at approximately \$90.1 million.

Under the acquisition method of accounting, the total purchase price is allocated to Monroe's net tangible and intangible assets based on their current fair values on the date of the acquisition. The purchase price for the Monroe acquisition is allocated as follows (in thousands):

Cash and cash equivalents	\$ 83,604
Trading securities	3,877
Investment securities available for sale	140,422
Investment securities held to maturity	6,972
Federal Home Loan Bank stock, at cost	2,323
Loans held for sale	6,328
Loans	447,038
Premises and equipment	19,738
Accrued interest receivable	1,804
Company-owned life insurance	17,206
Other assets	41,538
Deposits	(653,813)
Short-term borrowings	(62,529)
Other borrowings	(37,352)
Accrued expenses and other liabilities	(6,000)
Net tangible assets acquired	11,156
Definite-lived intangible assets acquired	10,485
Goodwill	68,429
Purchase price	\$ 90,070

Of the total purchase price, \$11.2 million has been allocated to net tangible assets acquired and \$10.5 million has been allocated to definite-lived intangible assets acquired. The remaining purchase price has been allocated to goodwill. The goodwill will not be deductible for tax purposes and is included in the Community Banking and Other segments, as described in Note 20 of these consolidated financial statement footnotes.



**Table of Contents**

The components of the estimated fair value of the acquired identifiable intangible assets are in the table below. These intangible assets will be amortized on an accelerated basis over their estimated lives and are included in the Community Banking and Other segments, as described in Note 20 of these consolidated financial statement footnotes.

	<b>Estimated Fair Value (in millions)</b>	<b>Estimated Useful Lives (Years)</b>
Core deposit intangible	\$ 8.2	10
Trust customer relationship intangible	\$ 2.3	12

**Divestiture**

On August 16, 2012, Old National announced plans to sell the deposits of nine banking centers located in southern Illinois and western Kentucky. As such, these deposits are considered held for sale as of September 30, 2012. The deposits totaled approximately \$168.0 million at September 30, 2012. Old National also announced plans to consolidate 19 banking centers into existing branch locations. The consolidations are scheduled for the fourth quarter of 2012 and the pending sales will close during the first quarter of 2013.

**Table of Contents****NOTE 4 NET INCOME PER SHARE**

The following table reconciles basic and diluted net income per share for the three and nine months ended September 30:

(dollars and shares in thousands, except per share data)	<b>Three Months Ended September 30, 2012</b>	<b>Three Months Ended September 30, 2011</b>
<b>Basic Earnings Per Share</b>		
Net income	\$ 19,737	\$ 16,797
Weighted average common shares outstanding	95,690	94,492
<b>Basic Earnings Per Share</b>	<b>\$ 0.20</b>	<b>\$ 0.18</b>
<b>Diluted Earnings Per Share</b>		
Net income	\$ 19,737	\$ 16,797
Weighted average common shares outstanding	95,690	94,492
Effect of dilutive securities:		
Restricted stock (1)	422	277
Stock options (2)	13	16
Weighted average shares outstanding	96,125	94,785
<b>Diluted Earnings Per Share</b>	<b>\$ 0.20</b>	<b>\$ 0.18</b>
(dollars and shares in thousands, except per share data)	<b>Nine Months Ended September 30, 2012</b>	<b>Nine Months Ended September 30, 2011</b>
<b>Basic Earnings Per Share</b>		
Net income	\$ 68,666	\$ 50,246
Weighted average common shares outstanding	94,886	94,468
<b>Basic Earnings Per Share</b>	<b>\$ 0.72</b>	<b>\$ 0.53</b>
<b>Diluted Earnings Per Share</b>		
Net income	\$ 68,666	\$ 50,246
Weighted average common shares outstanding	94,886	94,468
Effect of dilutive securities:		
Restricted stock (1)	371	233
Stock options (2)	17	21
Weighted average shares outstanding	95,274	94,722
<b>Diluted Earnings Per Share</b>	<b>\$ 0.72</b>	<b>\$ 0.53</b>

- (1) 7 and 2 shares of restricted stock and restricted stock units were not included in the computation of net income per diluted share for the third quarter ended September 30, 2012 and 2011, respectively, because the effect would be antidilutive. 7 and 5 shares of restricted stock and restricted stock units were not included in the computation of net income per diluted share for the nine months ended September 30, 2012 and 2011, respectively, because the effect would be antidilutive.
- (2) Options to purchase 3,267 shares and 4,626 shares outstanding at September 30, 2012 and 2011, respectively, were not included in the computation of net income per diluted share for the third quarter ended September 30, 2012 and 2011, respectively, because the

## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

exercise price of these options was greater than the average market price of the common shares and, therefore, the effect would be antidilutive. Options to purchase 3,286 and 4,605 shares outstanding at September 30, 2012 and 2011, respectively, were not included in the computation of net income per diluted share for the nine months ended September 30, 2012 and 2011, respectively, because the exercise price of these options was greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

**Table of Contents****NOTE 5 ACCUMULATED OTHER COMPREHENSIVE INCOME**

The following tables summarize the changes within each classification of accumulated other comprehensive income ( AOCI ) net of tax for the nine months ended September 30, 2012 and 2011:

(dollars in thousands)	AOCI at December 31, 2011	Other Comprehensive Income	AOCI at September 30, 2012
Unrealized gains on available-for-sale securities	\$ 53,911	\$ 18,977	\$ 72,888
Unrealized losses on securities for which other-than-temporary-impairment has been recognized	(29,299)		(29,299)
Unrealized gains (losses) on held-to-maturity securities	4,745	(1,368)	3,377
Unrecognized gain (loss) on cash flow hedges	145	(145)	
Defined benefit pension plans	(14,498)	1,812	(12,686)
Accumulated other comprehensive income (loss)	\$ 15,004	\$ 19,276	\$ 34,280

(dollars in thousands)	AOCI at December 31, 2010	Other Comprehensive Income	AOCI at September 30, 2011
Unrealized gains on available-for-sale securities	\$ 31,962	\$ 26,058	\$ 58,020
Unrealized losses on securities for which other-than-temporary-impairment has been recognized	(28,173)	(836)	(29,009)
Unrealized gains (losses) on held-to-maturity securities	5,667	(783)	4,884
Unrecognized gain on cash flow hedges	846	(481)	365
Defined benefit pension plans	(11,571)	1,882	(9,689)
Accumulated other comprehensive income (loss)	\$ (1,269)	\$ 25,840	\$ 24,571

**Table of Contents****NOTE 6 INVESTMENT SECURITIES**

The following table summarizes the amortized cost and fair value of the available-for-sale and held-to-maturity investment securities portfolio at September 30, 2012 and December 31, 2011 and the corresponding amounts of unrealized gains and losses therein:

(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>September 30, 2012</b>				
<b>Available-for-sale</b>				
U.S. Treasury	\$ 15,170	\$ 415	\$	\$ 15,585
U.S. Government-sponsored entities and agencies	384,975	2,698	(497)	387,176
Mortgage-backed securities Agency	1,104,394	35,582	(29)	1,139,947
Mortgage-backed securities Non-agency	31,734	1,346	(356)	32,724
States and political subdivisions	520,375	37,587	(127)	557,835
Pooled trust preferred securities	25,285		(16,191)	9,094
Other securities	160,913	11,289	(1,774)	170,428
Total available-for-sale securities	\$ 2,242,846	\$ 88,917	\$ (18,974)	\$ 2,312,789
<b>Held-to-maturity</b>				
U.S. Government-sponsored entities and agencies	\$ 174,764	\$ 13,247	\$	\$ 188,011
Mortgage-backed securities Agency	63,222	2,685		65,907
States and political subdivisions	169,539	13,561		183,100
Other securities	2,996			2,996
Total held-to-maturity securities	\$ 410,521	\$ 29,493	\$	\$ 440,014
<b>December 31, 2011</b>				
<b>Available-for-sale</b>				
U.S. Treasury	\$ 65,221	\$ 548	\$	\$ 65,769
U.S. Government-sponsored entities and agencies	171,629	1,621	(65)	173,185
Mortgage-backed securities Agency	1,153,629	28,687	(61)	1,182,255
Mortgage-backed securities Non-agency	90,355	418	(4,873)	85,900
States and political subdivisions	376,609	26,428	(193)	402,844
Pooled trust preferred securities	25,461		(18,134)	7,327
Other securities	147,897	8,365	(2,266)	153,996
Total available-for-sale securities	\$ 2,030,801	\$ 66,067	\$ (25,592)	\$ 2,071,276
<b>Held-to-maturity</b>				
U.S. Government-sponsored entities and agencies	\$ 177,159	\$ 11,434	\$	\$ 188,593
Mortgage-backed securities Agency	84,075	3,305		87,380
States and political subdivisions	216,345	8,548	(176)	224,717
Other securities	7,011		(2)	7,009
Total held-to-maturity securities	\$ 484,590	\$ 23,287	\$ (178)	\$ 507,699

**Table of Contents**

All of the mortgage-backed securities in the investment portfolio are residential mortgage-backed securities. The amortized cost and fair value of the investment securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Weighted average yield is based on amortized cost.

(dollars in thousands)	September 30, 2012		Weighted
Maturity	Amortized	Fair	Average
	Cost	Value	Yield
<b>Available-for-sale</b>			
Within one year	\$ 31,076	\$ 31,352	3.38%
One to five years	106,978	113,288	3.59
Five to ten years	538,964	554,625	2.72
Beyond ten years	1,565,828	1,613,524	3.30
Total	\$ 2,242,846	\$ 2,312,789	3.17%
<b>Held-to-maturity</b>			
Within one year	\$ 3,210	\$ 3,210	2.12%
One to five years	2,331	2,412	3.29
Five to ten years	142,409	151,219	2.91
Beyond ten years	262,571	283,173	4.46
Total	\$ 410,521	\$ 440,014	3.90%



**Table of Contents**

The following table summarizes the investment securities with unrealized losses at September 30, 2012 and December 31, 2011 by aggregated major security type and length of time in a continuous unrealized loss position:

(dollars in thousands)	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>September 30, 2012</b>						
<b>Available-for-Sale</b>						
U.S. Government-sponsored entities and agencies	\$ 109,574	\$ (497)	\$	\$	\$ 109,574	\$ (497)
Mortgage-backed securities Agency	12,310	(29)			12,310	(29)
Mortgage-backed securities Non-agency	2,459	(154)	3,561	(202)	6,020	(356)
States and political subdivisions	12,633	(127)			12,633	(127)
Pooled trust preferred securities			9,094	(16,191)	9,094	(16,191)
Other securities	2,484	(13)	6,324	(1,761)	8,808	(1,774)
<b>Total available-for-sale</b>	<b>\$ 139,460</b>	<b>\$ (820)</b>	<b>\$ 18,979</b>	<b>\$ (18,154)</b>	<b>\$ 158,439</b>	<b>\$ (18,974)</b>
<b>Held-to-Maturity</b>						
States and political subdivisions	\$	\$	\$ 50	\$	\$ 50	\$
<b>Total held-to-maturity</b>	<b>\$</b>	<b>\$</b>	<b>\$ 50</b>	<b>\$</b>	<b>\$ 50</b>	<b>\$</b>
<b>December 31, 2011</b>						
<b>Available-for-Sale</b>						
U.S. Government-sponsored entities and agencies	\$ 24,935	\$ (65)	\$	\$	\$ 24,935	\$ (65)
Mortgage-backed securities Agency	49,016	(61)	3		49,019	(61)
Mortgage-backed securities Non-agency	10,053	(353)	59,203	(4,520)	69,256	(4,873)
States and political subdivisions	9,281	(114)	1,345	(79)	10,626	(193)
Pooled trust preferred securities			7,327	(18,134)	7,327	(18,134)
Other securities	4,516	(141)	6,218	(2,125)	10,734	(2,266)
<b>Total available-for-sale</b>	<b>\$ 97,801</b>	<b>\$ (734)</b>	<b>\$ 74,096</b>	<b>\$ (24,858)</b>	<b>\$ 171,897</b>	<b>\$ (25,592)</b>
<b>Held-to-Maturity</b>						
States and political subdivisions	\$ 1,613	\$ (1)	\$ 13,180	\$ (175)	\$ 14,793	\$ (176)
Other securities	22	(2)			22	(2)
<b>Total held-to-maturity</b>	<b>\$ 1,635</b>	<b>\$ (3)</b>	<b>\$ 13,180</b>	<b>\$ (175)</b>	<b>\$ 14,815</b>	<b>\$ (178)</b>

Proceeds from sales and calls of securities available for sale were \$332.3 million and \$763.5 million for the nine months ended September 30, 2012 and 2011, respectively. Gains of \$10.4 million and \$6.0 million were realized on these sales during 2012 and 2011, respectively, and offsetting losses of \$1.0 million were realized on these sales during 2011. Also included in net securities gains for the first nine months of 2012 is \$120 thousand of gains associated with the trading securities and other-than-temporary impairment charges related to credit loss on six non-agency mortgage-backed securities and one trust preferred security in the amount of \$1.1 million, described below. Impacting earnings in the first nine months of 2011 was \$1 thousand of gains associated with the trading securities and other-than-temporary impairment charges related to credit loss on three non-agency mortgage-backed securities in the amount of \$499 thousand.

Trading securities, which consist of mutual funds held in a trust associated with deferred compensation plans for former Monroe Bancorp directors and executives, are recorded at fair value and totaled \$3.0 million at September 30, 2012 and \$2.8 million at December 31, 2011.

During the third quarter of 2012, approximately \$46.1 million of state and political subdivision securities were transferred from the held-to-maturity portfolio to the available-for-sale portfolio due to changes in circumstances associated with the Office of Management and Budget's report outlining sequestration and the implications for taxable Build America Bonds. The \$1.0 million, net of tax, unrealized holding gain was reclassified out of other comprehensive income on the date of transfer.



---

**Table of Contents**

Management evaluates securities for other-than-temporary impairment ( OTTI ) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available-for-sale or held-to-maturity are generally evaluated for OTTI under FASB ASC 320 (SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*). However, certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated using the model outlined in FASB ASC 325-10 (EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that Continue to be Held by a Transfer in Securitized Financial Assets*).

In determining OTTI under the FASB ASC 320 (SFAS No. 115) model, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. The second segment of the portfolio uses the OTTI guidance provided by FASB ASC 325-10 (EITF 99-20) that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the FASB ASC 325-10 model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When other-than-temporary-impairment occurs under either model, the amount of the other-than-temporary-impairment recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary-impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. Otherwise, the other-than-temporary-impairment shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary-impairment related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total other-than-temporary-impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

As of September 30, 2012, Old National's securities portfolio consisted of 1,297 securities, 55 of which were in an unrealized loss position. The Company's non-agency mortgage-backed and pooled trust preferred securities are discussed below. The majority of unrealized losses are related to the Company's pooled trust preferred securities.

**Non-agency Mortgage-backed Securities**

At September 30, 2012, the Company's securities portfolio contained 7 non-agency collateralized mortgage obligations with a fair value of \$32.7 million which had net unrealized gains of approximately \$1.0 million. All of these securities are residential mortgage-backed securities. These non-agency mortgage-backed securities were rated AAA at purchase and are not within the scope of FASB ASC 325-10 (EITF 99-20). As of September 30, 2012, five of these securities were rated below investment grade with grades ranging from CCC to D. One of the five securities is rated CCC and has a fair value of \$13.0 million, one of the securities is rated CC with a fair value of \$1.3 million and three of the securities are rated D with a fair value of \$9.4 million. These securities were evaluated to determine if the underlying collateral is expected to experience loss, resulting in a principal loss of the notes. As part of the evaluation, a detailed analysis of deal-specific data was obtained from remittance reports provided by the trustee and data from the servicer. The collateral was broken down into several distinct buckets based on loan performance characteristics in order to apply different assumptions to each bucket. The most significant drivers affecting loan performance were examined including original loan-to-value ( LTV ), underlying property location and the loan status. The loans in the current status bucket were further divided based on their original LTV: a high-LTV and a low-LTV group to which different default curves and severity percentages were applied. The high-LTV group was further bifurcated into loans originated in high-risk states and all other states with a higher default-curve and severity percentages being applied to loans originated in the high-risk states. Different default curves and severity rates were applied to the remaining non-current collateral buckets. Using these collateral-specific assumptions, a model was built to project the future performance of the instrument. Based on this analysis of the underlying collateral, Old National recorded \$913 thousand of credit losses on six of these securities for the nine months ended September 30, 2012. The fair value of these below investment grade non-agency mortgage-backed securities remaining at September 30, 2012 was \$23.8 million.

---

**Table of Contents**

Based on an analysis of the underlying collateral, Old National recorded \$499 thousand of credit losses on three non-agency mortgage-backed securities for the nine months ended September 30, 2011. The fair value of these non-agency mortgage-backed securities was \$78.5 million at September 30, 2011.

**Pooled Trust Preferred Securities**

At September 30, 2012, the Company's securities portfolio contained eight pooled trust preferred securities with a fair value of \$9.1 million and unrealized losses of \$16.2 million. Six of the pooled trust preferred securities in our portfolio fall within the scope of FASB ASC 325-10 (EITF 99-20) and have a fair value of \$3.7 million with unrealized losses of \$7.3 million at September 30, 2012. These securities were rated A2 and A3 at inception, but at September 30, 2012, one security was rated CC, four securities were rated C and one security D. The issuers in these securities are primarily banks, but some of the pools do include a limited number of insurance companies. The Company uses the OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine whether an adverse change in cash flows has occurred during the quarter. The OTTI model considers the structure and term of the collateralized debt obligation ( CDO ) and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. Assumptions used in the model include expected future default rates and prepayments. We assume no recoveries on defaults and a limited number of recoveries on current or projected interest payment deferrals. In addition, we use the model to stress each CDO, or make assumptions more severe than expected activity, to determine the degree to which assumptions could deteriorate before the CDO could no longer fully support repayment of Old National's note class. For the nine months ended September 30, 2012, our model indicated other-than-temporary-impairment losses on one security of \$165 thousand, all of which was recorded as a credit loss in earnings. At September 30, 2012, the fair value of this security was \$476 thousand and it was classified as available for sale.

Two of our pooled trust preferred securities with a fair value of \$5.4 million and unrealized losses of \$8.9 million at September 30, 2012 are not subject to FASB ASC 325-10. These securities are evaluated using collateral-specific assumptions to estimate the expected future interest and principal cash flows. Our analysis indicated no other-than-temporary-impairment on these securities.

For the nine months ended September 30, 2011, the seven securities subject to FASB ASC 325-10 accounted for \$8.3 million of the unrealized losses in the pooled trust preferred securities category. Our analysis indicated no other-than-temporary-impairment on these securities.

Two of our pooled trust preferred securities with a fair value of \$2.7 million and unrealized losses of \$11.5 million at September 30, 2011 were not subject to FASB ASC 325-10. These securities were evaluated using collateral-specific assumptions to estimate the expected future interest and principal cash flows. Our analysis indicated no other-than-temporary-impairment on these securities.

The table below summarizes the relevant characteristics of our eight pooled trust preferred securities as well as five single issuer trust preferred securities which are included with other securities in Note 6 to the consolidated financial statements. Each of the pooled trust preferred securities support a more senior tranche of security holders except for the MM Community Funding II security which, due to payoffs, Old National is now in the most senior class.

**Table of Contents**

As depicted in the table below, all eight securities have experienced credit defaults. However, two of these securities have excess subordination and are not other-than-temporarily-impaired as a result of their class hierarchy which provides more loss protection.

		Lowest Credit Rating (1)		Amortized Cost	Fair Value	Unrealized Gain/(Loss)	Realized Losses 2012	# of Issuers Currently Performing/Remaining	Actual Deferrals and Defaults as a Percent of Original Collateral	Expected Defaults as a % of Remaining Performing Collateral	Excess Subordination as a % of Current Performing Collateral
<b>Trust preferred securities</b>											
<b>September 30, 2012</b>											
<b>(Dollars in Thousands)</b>											
<b>Pooled trust preferred securities:</b>											
TROPC 2003-1A	A4L	C	\$ 86	\$ 86	\$	\$	14/36	43.6%	15.6%	0.0%	
MM Community Funding IX	B-2	CC	2,067	663	(1,404)		17/30	34.4%	7.5%	0.0%	
Reg Div Funding 2004	B-2	D	4,012	476	(3,536)	165	24/45	45.7%	6.2%	0.0%	
Pretsl XII	B-1	C	2,820	1,324	(1,496)		48/73	27.9%	8.0%	0.0%	
Pretsl XV	B-1	C	1,695	1,139	(556)		49/71	32.6%	6.2%	0.0%	
Reg Div Funding 2005	B-1	C	311	23	(288)		18/48	55.9%	30.1%	0.0%	
Pretsl XXVII LTD	B	CC	4,892	1,164	(3,728)		34/49	26.6%	4.4%	34.0%	
Trapeza Ser 13A	A2A	B	9,402	4,219	(5,183)		43/53	27.7%	7.4%	35.3%	
			25,285	9,094	(16,191)	165					
<b>Single Issuer trust preferred securities:</b>											
First Empire Cap (M&T)		BB+	957	998	41						
First Empire Cap (M&T)		BB+	2,907	2,993	86						
Fleet Cap Tr V (BOA)		BB	3,364	2,501	(863)						
JP Morgan Chase Cap XIII		BBB	4,721	3,823	(898)						
NB-Global		BB	715	713	(2)						
			12,664	11,028	(1,636)						
Total			\$ 37,949	\$ 20,122	\$ (17,827)	\$ 165					

(1) Lowest rating for the security provided by any nationally recognized credit rating agency.

The following table details all securities with other-than-temporary-impairment, their credit rating at September 30, 2012 and the related credit losses recognized in earnings:

	Vintage	Lowest Credit Rating (1)	Amortized Cost	Amount of other-than-temporary impairment recognized in earnings Three months ended	
				September 30, 2012	Nine months ended September 30, 2012
<b>Non-agency mortgage-backed securities:</b>					
BAFC Ser 4	2007	CCC	\$ 12,319	\$ 139	\$ 299
CWALT Ser 73CB	2005	D	2,613	23	140
CWALT Ser 73CB	2005	D	3,762	21	21

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

HALO Ser 1R	2006				133
RAST A9	2004				142
RFMSI Ser S10	2006	D	3,260	15	178
			\$ 21,954	198	913
Pooled trust preferred securities:					
Reg Div Funding	2004	D	4,012	4	165
			\$ 4,012	4	165
Total other-than-temporary- impairment recognized in earnings				\$ 202	\$ 1,078

(1) Lowest rating for the security provided by any nationally recognized credit rating agency.

**Table of Contents**

The following table details all securities with other-than-temporary-impairment, their credit rating at September 30, 2011 and the related credit losses recognized in earnings:

	Vintage	Lowest Credit Rating (1)	Amortized Cost	Amount of other-than-temporary impairment recognized in earnings	
				Three months ended September 30, 2011	Nine months ended September 30, 2011
<b>Non-agency mortgage-backed securities:</b>					
FHASI Ser 4	2007	CC	\$ 20,003	\$	\$ 340
HALO Ser 1R	2006	B	15,640		16
RFMSI Ser S10	2006	CC	4,217		143
			\$ 39,860		499
Total other-than-temporary- impairment recognized in earnings				\$	\$ 499

(1) Lowest rating for the security provided by any nationally recognized credit rating agency.

The following table details all securities with other-than-temporary-impairment, their credit rating at September 30, 2012, and the related life-to-date credit losses recognized in earnings:

	Vintage	Lowest Credit Rating (1)	Amortized Cost	Nine Months September 30, 2012	Amount of other-than-temporary impairment recognized in earnings			Life-to-date
					Year ended December 31, 2011	2010	2009	
<b>Non-agency mortgage-backed securities:</b>								
BAFC Ser 4	2007	CCC	\$ 12,319	\$ 299	\$ 79	\$ 63	\$ 441	
CWALT Ser 73CB	2005	D	2,613	140	207	83	430	
CWALT Ser 73CB	2005	D	3,762	21	427	182	630	
CWHL 2006-10 (3)	2006				309	762	1,071	
CWHL 2005-20	2005	CC	1,242		39	72	111	
FHASI Ser 4 (5)	2007				340	629	1,192	
HALO Ser 1R (5)	2006			133	16		149	
RFMSI Ser S9 (2)	2006				923	1,880	2,803	
RFMSI Ser S10	2006	D	3,260	178	165	76	249	
RALI QS2 (2)	2006				278	739	1,017	
RAST A9	2004			142			142	
RFMSI S1(4)	2006				30	176	206	
			23,196	913	521	2,997	4,429	8,860
<b>Pooled trust preferred securities:</b>								
TROPC	2003	C	86		888	444	3,517	4,849
MM Community Funding IX	2003	CC	2,067			165	2,612	2,777
Reg Div Funding	2004	D	4,012	165		321	5,199	5,685
Pretsl XII	2003	C	2,820				1,897	1,897
Pretsl XV	2004	C	1,695				3,374	3,374
Reg Div Funding	2005	C	311				3,767	3,767

## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

	10,991	165	888	930	20,366	22,349
Total other-than-temporary- impairment recognized in earnings		\$ 1,078	\$ 1,409	\$ 3,927	\$ 24,795	\$ 31,209

- (1) Lowest rating for the security provided by any nationally recognized credit rating agency.
- (2) Sold during fourth quarter 2010.
- (3) Sold during first quarter 2011.
- (4) Sold during second quarter 2012.
- (5) Sold during third quarter 2012.



**Table of Contents****NOTE 7 LOANS HELD FOR SALE**

Residential loans that Old National has committed to sell are recorded at fair value in accordance with FASB ASC 825-10 (SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*). At September 30, 2012 and December 31, 2011, Old National had residential loans held for sale of \$9.9 million and \$4.5 million, respectively.

During the first nine months of 2012, commercial and commercial real estate loans held for investment of \$1.6 million, including \$1.5 million of purchased impaired loans, were reclassified to loans held for sale at the lower of cost or fair value and sold for \$2.3 million, resulting in a charge-off of \$0.1 million and a recovery of \$0.8 million. At September 30, 2012, there were no loans held for sale under this arrangement.

During the first nine months of 2011, commercial and commercial real estate loans held for investment of \$4.7 million, including \$0.1 million of purchased impaired loans, were reclassified to loans held for sale at the lower of cost or fair value and sold for \$4.9 million, resulting in income of \$0.2 million. At September 30, 2011, there were no loans held for sale under this arrangement.

**NOTE 8 LOANS AND ALLOWANCE FOR CREDIT LOSSES**

Old National's finance receivables consist primarily of loans made to consumers and commercial clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling and retailing. Most of Old National's lending activity occurs within the Company's principal geographic markets of Indiana, Illinois and Kentucky. Old National has no concentration of commercial loans in any single industry exceeding 10% of its portfolio.

The composition of loans by lending classification was as follows:

(dollars in thousands)	September 30, 2012	December 31, 2011
Commercial (1)	\$ 1,294,015	\$ 1,216,654
Commercial real estate:		
Construction	113,772	46,141
Other	1,177,282	1,021,229
Residential real estate	1,279,238	995,458
Consumer credit:		
Heloc	269,398	235,603
Auto	526,662	483,575
Other	134,010	142,183
Covered loans	448,789	626,360
<b>Total loans</b>	<b>5,243,166</b>	<b>4,767,203</b>
Allowance for loan losses	(50,428)	(57,117)
Allowance for loan losses - covered loans	(4,334)	(943)
<b>Net loans</b>	<b>\$ 5,188,404</b>	<b>\$ 4,709,143</b>

(1) Includes direct finance leases of \$62.6 million at September 30, 2012 and \$79.6 million at December 31, 2011.

The risk characteristics of each loan portfolio segment are as follows:

**Commercial**

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable,

the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

## Table of Contents

### Commercial real estate

These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing Old National's commercial real estate portfolio are diverse in terms of type and geographic location. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, Old National avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Included with commercial real estate, construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based on estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from Old National until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

### Residential

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, Old National typically establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Portfolio loans, or loans Old National intends to hold for investment purposes, are carried at the principal balance outstanding, net of earned interest, purchase premiums or discounts, deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the principal balances of loans outstanding.

### Consumer

Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Portfolio loans, or loans Old National intends to hold for investment purposes, are carried at the principal balance outstanding, net of earned interest, purchase premiums or discounts, deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the principal balances of loans outstanding.

**Table of Contents****Covered Loans**

On July 29, 2011, Old National acquired the banking operations of Integra Bank N.A. ( Integra ) in an FDIC assisted transaction. As part of the purchase and assumption agreement, the Company and the FDIC entered into loss sharing agreements (each, a loss sharing agreement and collectively, the loss sharing agreements ), whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded commitments), other real estate owned ( OREO ) and up to 90 days of certain accrued interest on loans. The acquired loans and OREO subject to the loss sharing agreements are referred to collectively as covered assets. Under the terms of the loss sharing agreements, the FDIC will reimburse Old National for 80% of losses up to \$275.0 million, losses in excess of \$275.0 million up to \$467.2 million at 0% reimbursement, and 80% of losses in excess of \$467.2 million. As of September 30, 2012, we do not expect losses to exceed \$275.0 million. Old National will reimburse the FDIC for its share of recoveries with respect to losses for which the FDIC has reimbursed the Bank under the loss sharing agreements. The loss sharing provisions of the agreements for commercial and single family residential mortgage loans are in effect for five and ten years, respectively, from the July 29, 2011 acquisition date and the loss recovery provisions for such loans are in effect for eight years and ten years, respectively, from the acquisition date.

**Allowance for loan losses**

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses incurred in the loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, historical loss experience, and assessments of the impact of current economic conditions on the portfolio.

The allowance is increased through a provision charged to operating expense. Loans deemed to be uncollectible are charged to the allowance. Recoveries of loans previously charged-off are added to the allowance.

No allowance is brought forward on any of the acquired loans as any credit deterioration evident in the loans was included in the determination of the fair value of the loans at the acquisition date. Purchased credit impaired ( PCI ) loans would not be considered impaired until after the point at which there has been a degradation of cash flows below our expected cash flows at acquisition. Impairment on PCI loans would be recognized in the current period as provision expense.

Old National's activity in the allowance for loan losses for the three months ended September 30, 2012 and 2011 is as follows:

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
<b>2012</b>						
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 17,850	\$ 28,621	\$ 4,682	\$ 3,607		\$ 54,760
Charge-offs	(2,485)	(771)	(1,385)	(545)		(5,186)
Recoveries	1,647	2,300	565	276		4,788
Provision	954	(945)	663	(272)		400
Ending balance	\$ 17,966	\$ 29,205	\$ 4,525	\$ 3,066		\$ 54,762

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
<b>2011</b>						
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 26,029	\$ 32,490	\$ 8,558	\$ 3,112		\$ 70,189
Charge-offs	(2,227)	(2,726)	(2,149)	(344)		(7,446)
Recoveries	902	482	1,405	72		2,861
Provision	(864)	315	130	337		(82)

Ending balance	\$ 23,840	\$ 30,561	\$ 7,944	\$ 3,177	\$ 65,522
----------------	-----------	-----------	----------	----------	-----------

**Table of Contents**

Old National's activity in the allowance for loan losses for the nine months ended September 30, 2012 and 2011 is as follows:

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
<b>2012</b>						
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 19,964	\$ 26,993	\$ 6,954	\$ 4,149		\$ 58,060
Charge-offs	(5,725)	(4,864)	(5,935)	(1,465)		(17,989)
Recoveries	3,940	4,421	3,090	391		11,842
Provision	(213)	2,655	416	(9)		2,849
Ending balance	\$ 17,966	\$ 29,205	\$ 4,525	\$ 3,066		\$ 54,762

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
<b>2011</b>						
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 26,204	\$ 32,654	\$ 11,142	\$ 2,309		\$ 72,309
Charge-offs	(7,396)	(5,707)	(8,002)	(1,517)		(22,622)
Recoveries	3,037	1,466	4,731	164		9,398
Provision	1,995	2,148	73	2,221		6,437
Ending balance	\$ 23,840	\$ 30,561	\$ 7,944	\$ 3,177		\$ 65,522

The following tables provide Old National's recorded investment in financing receivables by portfolio segment at September 30, 2012 and December 31, 2011 and other information regarding the allowance:

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
<b>September 30, 2012</b>						
<b>Allowance for loan losses:</b>						
Ending balance: individually evaluated for impairment	\$ 6,625	\$ 4,233	\$	\$		\$ 10,858
Ending balance: collectively evaluated for impairment	\$ 10,559	\$ 16,977	\$ 2,604	\$ 2,926		\$ 33,066
Ending balance: loans acquired with deteriorated credit quality	\$ 427	\$ 4,941	1,066	\$ 70		\$ 6,504
Ending balance: covered loans acquired with deteriorated credit quality	\$ 355	\$ 3,054	\$ 855	\$ 70		\$ 4,334
Total allowance for credit losses	\$ 17,966	\$ 29,205	\$ 4,525	\$ 3,066		\$ 54,762
<b>Loans and leases outstanding:</b>						
Ending balance: individually evaluated for impairment	\$ 34,812	\$ 43,469				\$ 78,281
Ending balance: collectively evaluated for impairment	\$ 1,248,264	\$ 1,191,275	\$ 930,070	\$ 1,279,238		\$ 4,648,847

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Ending balance: loans acquired with deteriorated credit quality	\$ 10,939	\$ 56,310			\$ 67,249
Ending balance: covered loans acquired with deteriorated credit quality	\$ 69,501	\$ 237,113	\$ 104,348	\$ 37,827	\$ 448,789
Total loans and leases outstanding	\$ 1,363,516	\$ 1,528,167	\$ 1,034,418	\$ 1,317,065	\$ 5,243,166

**Table of Contents**

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
<b>December 31, 2011</b>						
<b>Allowance for loan losses:</b>						
Ending balance: individually evaluated for impairment	\$ 7,015	\$ 4,177				\$ 11,192
Ending balance: collectively evaluated for impairment	\$ 12,816	\$ 21,397	\$ 6,335	\$ 2,752		\$ 43,300
Ending balance: loans acquired with deteriorated credit quality	\$ 128	\$ 1,288	\$ 445	\$ 764		\$ 2,625
Ending balance: covered loans acquired with deteriorated credit quality	\$ 5	\$ 131	\$ 174	\$ 633		\$ 943
<b>Total allowance for credit losses</b>	<b>\$ 19,964</b>	<b>\$ 26,993</b>	<b>\$ 6,954</b>	<b>\$ 4,149</b>		<b>\$ 58,060</b>
<b>Loans and leases outstanding:</b>						
Ending balance: individually evaluated for impairment	\$ 31,838	\$ 43,225				\$ 75,063
Ending balance: collectively evaluated for impairment	\$ 1,183,675	\$ 1,002,105	\$ 861,361	\$ 995,458		\$ 4,042,599
Ending balance: loans acquired with deteriorated credit quality	\$ 1,141	\$ 22,040				\$ 23,181
Ending balance: covered loans acquired with deteriorated credit quality	\$ 124,755	\$ 325,934	\$ 128,700	\$ 46,971		\$ 626,360
<b>Total loans and leases outstanding</b>	<b>\$ 1,341,409</b>	<b>\$ 1,393,304</b>	<b>\$ 990,061</b>	<b>\$ 1,042,429</b>		<b>\$ 4,767,203</b>

**Credit Quality**

Old National's management monitors the credit quality of its financing receivables in an on-going manner. Internally, management assigns a credit quality grade to each non-homogeneous commercial and commercial real estate loan in the portfolio. The primary determinants of the credit quality grade are based upon the reliability of the primary source of repayment and the past, present, and projected financial condition of the borrower. The credit quality rating also reflects current economic and industry conditions. Major factors used in determining the grade can vary based on the nature of the loan, but commonly include factors such as debt service coverage, internal cash flow, liquidity, leverage, operating performance, debt burden, FICO scores, occupancy, interest rate sensitivity, and expense burden. Old National uses the following definitions for risk ratings:

**Criticized.** Special mention loans that have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Classified Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Classified Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Pass rated loans are those loans that are other than criticized, classified substandard or classified doubtful.



**Table of Contents**

As of September 30, 2012 and December 31, 2011, the risk category of loans, excluding covered loans, by class of loans is as follows:

(dollars in thousands)

Corporate Credit Exposure by Internally Assigned Grade	Commercial		Commercial Real Estate- Construction		Commercial Real Estate- Other	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
	Grade:					
Pass	\$ 1,163,480	\$ 1,103,556	\$ 69,336	\$ 16,841	\$ 972,610	\$ 895,543
Criticized	56,467	36,212	10,413	13,605	68,373	30,331
Classified substandard	31,006	41,695	14,521	10,147	41,732	34,478
Classified doubtful	43,062	35,191	19,502	5,548	94,567	60,877
Total	\$ 1,294,015	\$ 1,216,654	\$ 113,772	\$ 46,141	\$ 1,177,282	\$ 1,021,229

Old National considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, Old National also evaluates credit quality based on the aging status of the loan and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of September 30, 2012 and December 31, 2011, excluding covered loans:

September 30, 2012 (dollars in thousands)	Heloc	Consumer Auto	Other	Residential
Performing	\$ 268,050	\$ 525,097	\$ 132,304	\$ 1,269,005
Nonperforming	1,348	1,565	1,706	10,233
	\$ 269,398	\$ 526,662	\$ 134,010	\$ 1,279,238

December 31, 2011 (dollars in thousands)	Heloc	Consumer Auto	Other	Residential
Performing	\$ 234,334	\$ 481,632	\$ 140,605	\$ 985,211
Nonperforming	1,269	1,943	1,578	10,247
	\$ 235,603	\$ 483,575	\$ 142,183	\$ 995,458

**Impaired Loans**

Large commercial credits are subject to individual evaluation for impairment. Retail credits and other small balance credits that are part of a homogeneous group are not tested for individual impairment. A loan is considered impaired when it is probable that contractual interest and principal payments will not be collected either for the amounts or by the dates as scheduled in the loan agreement. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Old National's policy, for all but purchased credit impaired loans, is to recognize interest income on impaired loans unless the loan is placed on nonaccrual status. For the nine months ended September 30, 2012 and 2011, the average balance of impaired loans was \$76.7 million and \$66.4 million, respectively, for which no interest income was recorded. No additional funds are committed to be advanced in connection with these impaired loans.

The following table shows Old National's impaired loans, excluding covered loans, that are individually evaluated as of September 30, 2012 and December 31, 2011. Of the loans purchased during 2011 and 2012 without FDIC loss share coverage, only those that have experienced subsequent impairment since the date acquired are included in the table below. Purchased loans of \$4.2 million migrated to classified-doubtful during the third quarter of 2012. Purchased loans of \$24.0 million migrated to classified-doubtful during the year ended December 31, 2011.



**Table of Contents**

(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>September 30, 2012</b>			
With no related allowance recorded:			
Commercial	\$ 10,396	\$ 14,134	\$
Commercial Real Estate Construction	980	1,088	
Commercial Real Estate Other	14,560	21,404	
With an allowance recorded:			
Commercial	24,416	28,745	6,625
Commercial Real Estate Construction	4,671	4,671	69
Commercial Real Estate Other	23,258	25,927	4,164
<b>Total Commercial</b>	<b>\$ 78,281</b>	<b>\$ 95,969</b>	<b>\$ 10,858</b>
<b>December 31, 2011</b>			
With no related allowance recorded:			
Commercial	\$ 10,094	\$ 13,047	\$
Commercial Real Estate Construction	610	610	
Commercial Real Estate Other	18,136	27,372	
With an allowance recorded:			
Commercial	21,744	24,928	7,143
Commercial Real Estate Construction	2,256	3,327	12
Commercial Real Estate Other	22,223	24,792	5,453
<b>Total Commercial</b>	<b>\$ 75,063</b>	<b>\$ 94,076</b>	<b>\$ 12,608</b>

The average balance of impaired loans, excluding covered loans, and interest income recognized on impaired loans during the three months ended September 30, 2012 and 2011 are included in the tables below.

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized (1)
<b>September 30, 2012</b>		
With no related allowance recorded:		
Commercial	\$ 8,514	\$ 40
Commercial Real Estate Construction	1,322	2
Commercial Real Estate Other	13,417	27
With an allowance recorded:		
Commercial	19,372	(10)
Commercial Real Estate Construction	438	(2)
Commercial Real Estate Other	23,246	(1)
<b>Total Commercial</b>	<b>\$ 66,309</b>	<b>\$ 56</b>

(1) The Company does not record interest on nonaccrual loans until principal is recovered.

**Table of Contents**

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized (1)
September 30, 2011		
With no related allowance recorded:		
Commercial	\$ 12,081	\$ 178
Commercial Real Estate Construction		
Commercial Real Estate Other	11,409	64
With an allowance recorded:		
Commercial	22,118	59
Commercial Real Estate Construction		
Commercial Real Estate Other	32,243	194
Total Commercial	\$ 77,851	\$ 495

(1) The Company does not record interest on nonaccrual loans until principal is recovered. The average balance of impaired loans, excluding covered loans, and interest income recognized on impaired loans during the nine months ended September 30, 2012 and 2011 are included in the tables below.

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized (1)
September 30, 2012		
With no related allowance recorded:		
Commercial	\$ 10,246	\$ 40
Commercial Real Estate Construction	796	2
Commercial Real Estate Other	16,349	70
With an allowance recorded:		
Commercial	23,081	58
Commercial Real Estate Construction	3,464	
Commercial Real Estate Other	22,741	54
Total Commercial	\$ 76,677	\$ 224

(1) The Company does not record interest on nonaccrual loans until principal is recovered.

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized (1)
September 30, 2011		
With no related allowance recorded:		
Commercial	\$ 11,833	\$ 268
Commercial Real Estate Construction		
Commercial Real Estate Other	10,713	169
With an allowance recorded:		
Commercial	17,103	145
Commercial Real Estate Construction		

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Commercial Real Estate	Other	26,780	328
Total Commercial		\$ 66,429	\$ 910

(1) The Company does not record interest on nonaccrual loans until principal is recovered.

**Table of Contents**

For all loan classes, a loan is generally placed on nonaccrual status when principal or interest becomes 90 days past due unless it is well secured and in the process of collection, or earlier when concern exists as to the ultimate collectibility of principal or interest. Interest accrued during the current year on such loans is reversed against earnings. Interest accrued in the prior year, if any, is charged to the allowance for loan losses. Cash interest received on these loans is applied to the principal balance until the principal is recovered or until the loan returns to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, remain current for six months and future payments are reasonably assured.

Covered loans accounted for under FASB ASC Topic 310-30 accrue interest, even though they may be contractually past due, as any nonpayment of contractual principal or interest is considered in the periodic re-estimation of expected cash flows and is included in the resulting recognition of current period covered loan loss provision or prospective yield adjustments. Similar to uncovered loans, covered loans accounted for outside FASB ASC Topic 310-30 are classified as nonaccrual when, in the opinion of management, collection of principal or interest is doubtful. Information for covered loans accounted for both under and outside FASB ASC Topic 310-30 is included in the table below in the row labeled covered loans.

Old National's past due financing receivables as of September 30, 2012 and December 31, 2011 are as follows:

(dollars in thousands)	Recorded Investment >			Nonaccrual	Total Past Due	Current
	30-59 Days Past Due	60-89 Days Past Due	90 Days and Accruing			
<b>September 30, 2012</b>						
Commercial	\$ 857	\$ 968	\$ 180	\$ 41,187	\$ 43,192	\$ 1,250,823
<b>Commercial Real Estate:</b>						
Construction				19,208	19,208	94,564
Other	2,025	2,868	50	86,347	91,290	1,085,992
<b>Consumer:</b>						
Heloc	832	108		1,348	2,288	267,110
Auto	3,875	834	320	1,565	6,594	520,068
Other	1,816	549	31	1,706	4,102	129,908
Residential	14,362	2,060		10,233	26,655	1,252,583
Covered loans	1,793	759	64	123,741	126,357	322,432
<b>Total loans</b>	<b>\$ 25,560</b>	<b>\$ 8,146</b>	<b>\$ 645</b>	<b>\$ 285,335</b>	<b>\$ 319,686</b>	<b>\$ 4,923,480</b>
<b>December 31, 2011</b>						
Commercial	\$ 2,755	\$ 357	\$ 358	\$ 34,104	\$ 37,574	\$ 1,179,080
<b>Commercial Real Estate:</b>						
Construction		164		5,425	5,589	40,552
Other	7,466	413	279	60,762	68,920	952,309
<b>Consumer:</b>						
Heloc	706	186	151	1,269	2,312	233,291
Auto	5,745	1,276	246	1,943	9,210	474,365
Other	2,002	463	76	1,578	4,119	138,064
Residential	7,950	1,839		10,247	20,036	975,422
Covered loans	5,446	2,033	2,338	182,880	192,697	433,663
<b>Total loans</b>	<b>\$ 32,070</b>	<b>\$ 6,731</b>	<b>\$ 3,448</b>	<b>\$ 298,208</b>	<b>\$ 340,457</b>	<b>\$ 4,426,746</b>

**Loan Participations**

Old National has loan participations, which qualify as participating interests, with other financial institutions. At September 30, 2012, these loans totaled \$256.8 million, of which \$162.6 million had been sold to other financial institutions and \$94.2 million was retained by Old National. The loan participations convey proportionate ownership rights with equal priority to each participating interest holder, involve no recourse (other than ordinary representations and warranties) to, or subordination by, any participating interest holder, all cash flows are divided

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

among the participating interest holders in proportion to each holder's share of ownership and no holder has the right to pledge the entire financial asset unless all participating interest holders agree.

---

**Table of Contents**

**Troubled Debt Restructurings**

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

Any loans that are modified are reviewed by Old National to identify if a troubled debt restructuring ( TDR ) has occurred, which is when for economic or legal reasons related to a borrower s financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status. During the nine months ended September 30, 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate of new debt with similar risk, or a permanent reduction of the recorded investment of the loan.

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

If the Company is unable to resolve a nonperforming loan issue the credit will be charged off when it is apparent there will be a loss. For large commercial type loans, each relationship is individually analyzed for evidence of apparent loss based on quantitative benchmarks or subjectively based upon certain events or particular circumstances. It is Old National s policy to charge off small commercial loans scored through our small business credit center with contractual balances under \$250,000 that have been placed on nonaccrual status or became ninety days or more delinquent, without regard to the collateral position. For residential and consumer loans, a charge off is recorded at the time foreclosure is initiated or when the loan becomes 120 to 180 days past due, whichever is earlier.

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

For consumer and residential troubled debt restructurings, an additional amount is added to the loan loss reserve that represents the difference in the present value of the cash flows between the original terms and the new terms of the modified loan, using the original effective interest rate of the loan as a discount rate.

At September 30, 2012, our troubled debt restructurings consisted of \$9.9 million of commercial loans, \$18.3 million of commercial real estate loans, \$0.3 million of consumer loans and \$0.3 million of residential loans, totaling \$28.8 million. Approximately \$16.6 million of the troubled debt restructuring at September 30, 2012 were included with nonaccrual loans. At December 31, 2011, our troubled debt restructurings consisted of \$7.1 million of commercial loans, \$5.8 million of commercial real estate loans and \$0.1 million of consumer loans, totaling \$13.0 million. Approximately \$11.7 million of the troubled debt restructuring at December 31, 2011 were included with nonaccrual loans.

As of September 30, 2012 and December 31, 2011, Old National has allocated \$4.1 million and \$1.5 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings, respectively.



**Table of Contents**

Old National has not committed to lend any additional amounts as of September 30, 2012 and December 31, 2011, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine months ended September 30, 2012:

(dollars in thousands)	Number of Loans	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
<b>Troubled Debt Restructuring:</b>			
Commercial	32	\$ 5,594	\$ 5,594
Commercial Real Estate construction	3	1,392	1,392
Commercial Real Estate other	25	15,073	15,073
Consumer other	12	605	605
<b>Total</b>	<b>72</b>	<b>\$ 22,664</b>	<b>\$ 22,664</b>

The troubled debt restructurings described above increased the allowance for loan losses by \$1.3 million and resulted in charge-offs of \$0.9 million during the nine months ended September 30, 2012. The loans that impacted the allowance were charged off or paid prior to September 30, 2012.

The following table presents loans by class modified as troubled debt restructurings that occurred during the twelve months ended December 31, 2011:

(dollars in thousands)	Number of Loans	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
<b>Troubled Debt Restructuring:</b>			
Commercial	25	\$ 7,086	\$ 7,086
Commercial Real Estate construction	1	1,422	1,422
Commercial Real Estate other	46	5,956	4,429
Consumer other	1	53	53
<b>Total</b>	<b>73</b>	<b>\$ 14,517</b>	<b>\$ 12,990</b>

The troubled debt restructurings described above increased the allowance for loan losses by \$1.4 million and resulted in charge-offs of \$5.6 million during the twelve months ended December 31, 2011.

The following table presents loans by class modified as troubled debt restructuring within the last twelve months for which there was a payment default during the nine months ended September 30, 2012.

(dollars in thousands)	Number of Contracts	Recorded Investment
<b>Troubled Debt Restructuring That Subsequently Defaulted:</b>		
Commercial	4	\$ 400
Commercial Real Estate	3	126
<b>Total</b>	<b>7</b>	<b>\$ 526</b>



**Table of Contents**

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the twelve months ended December 31, 2011:

(dollars in thousands)	Number of Contracts	Recorded Investment
<b>Troubled Debt Restructuring That Subsequently Defaulted:</b>		
Commercial	3	\$ 1,647
Commercial Real Estate	6	1,587
<b>Total</b>	<b>9</b>	<b>\$ 3,234</b>

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above decreased the allowance for loan losses by \$0.6 million and resulted in charge-offs of \$3.0 million during the twelve months ended December 31, 2011.

The terms of certain other loans were modified during the nine months ended September 30, 2012 that did not meet the definition of a troubled debt restructuring. It is our process to review all classified and criticized loans that, during the period, have been renewed, have entered into a forbearance agreement, have gone from principal and interest to interest only, or have had the maturity date extended. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on its debt in the foreseeable future without the modification. The evaluation is performed under the Company's internal underwriting policy. We also evaluate whether a concession has been granted or if we were adequately compensated through a market interest rate, additional collateral or a bona fide guarantee. We also consider whether the modification was insignificant relative to the other terms of the agreement or if the delay in a payment was 90 days or less.

Purchased credit impaired ( PCI ) loans would not be considered impaired until after the point at which there has been a degradation of cash flows below our expected cash flows at acquisition. If a PCI loan is subsequently modified, and meets the definition of a TDR, it will be removed from PCI accounting and accounted for as a TDR only if the PCI loan was being accounted for individually. If the purchased credit impaired loan is being accounted for as part of a pool, it will not be removed from the pool.

In general, once a modified loan is considered a TDR, the loan will always be considered a TDR, and therefore impaired, until it is paid in full, otherwise settled, sold or charged off. However, our policy also permits for loans to be removed from troubled debt restructuring status in the years following the restructuring if the following two conditions are met: (1) The restructuring agreement specifies an interest rate equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk, and (2) the loan is not impaired based on the terms specified by the restructuring agreement.

**Table of Contents**

The following table presents activity in troubled debt restructurings for the nine months ended September 30, 2012 and 2011:

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Total
<b>2012</b>					
Troubled debt restructuring:					
Balance, January 1, 2012	\$ 7,086	\$ 5,851	\$ 53	\$	\$ 12,990
Charge-offs	(1,381)	(796)			(2,177)
Payments	(1,314)	(3,245)	(13)	(32)	(4,604)
Additions	5,556	16,426	266	368	22,616
<b>Balance September 30, 2012</b>	<b>\$ 9,947</b>	<b>\$ 18,236</b>	<b>\$ 306</b>	<b>\$ 336</b>	<b>\$ 28,825</b>

(dollars in thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Total
<b>2011</b>					
Troubled debt restructuring:					
Balance, January 1, 2011	\$ 3,778	\$ 972	\$ 65	\$	\$ 4,815
Charge-offs	(394)	(233)			(627)
Payments	(314)	(361)	(5)		(680)
Additions	809	5,116			5,925
<b>Balance September 30, 2011</b>	<b>\$ 3,879</b>	<b>\$ 5,494</b>	<b>\$ 60</b>	<b>\$</b>	<b>\$ 9,433</b>

**Purchased Impaired Loans (non-covered loans)**

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan and lease losses. In determining the estimated fair value of purchased loans, management considers a number of factors including the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, net present value of cash flows expected to be received, among others. Purchased loans are accounted for in accordance with guidance for certain loans acquired in a transfer (ASC 310-30), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan and lease losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income.

**Table of Contents**

Old National has purchased loans for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. Of these acquired credit impaired loans, \$4.0 million in carrying balances did not meet the criteria to be accounted for under the guidance of ASC 310-30 as they were revolving lines of credit, thus these lines have not been included in the following table. For these noncovered loans that meet the criteria of ASC 310-30 treatment, the carrying amount was as follows:

(dollars in thousands)	September 30, 2012	December 31, 2011
Commercial	\$ 10,959	\$ 1,143
Commercial real estate	59,944	23,059
Consumer	25,752	41,064
Residential	165	418
<b>Carrying amount</b>	<b>\$ 96,820</b>	<b>\$ 65,684</b>
Carrying amount, net of allowance	\$ 94,650	\$ 63,982
<b>Allowance for loan losses</b>	<b>\$ 2,170</b>	<b>\$ 1,702</b>

The outstanding balance of noncovered loans accounted for under ASC 310-30, including contractual principal, interest, fees and penalties, was \$194.1 million and \$111.4 million as of September 30, 2012 and December 31, 2011, respectively.

The accretable difference on purchased loans acquired in a business combination is the difference between the expected cash flows and the net present value of expected cash flows with such difference accreted into earnings using the effective yield method over the term of the loans. The accretable difference for noncovered loans that is expected to be accreted into future earnings of the Company totaled \$25.3 million at the date of acquisition. Accretion of \$7.9 million has been recorded as loan interest income through the nine months ended September 30, 2012. Accretion of \$15.3 million was recorded as loan interest income in 2011. Improvement in cash flow expectations has resulted in a reclassification from nonaccretable difference to accretable yield.

Accretable yield of noncovered loans, or income expected to be collected, is as follows:

(dollars in thousands)	Monroe	Integra Noncovered	IBT	Total
Balance at January 1, 2012	\$ 15,508	\$ 5,871	\$	\$ 21,379
New loans purchased			11,945	11,945
Accretion of income	(5,969)	(1,639)	(304)	(7,912)
Reclassifications from (to) nonaccretable difference	5,858	(140)		5,718
Disposals/other adjustments	(268)	(172)		(440)
Balance at September 30, 2012	\$ 15,129	\$ 3,920	\$ 11,641	\$ 30,690

Included in Old National's allowance for loan losses is \$2.2 million related to the purchased loans disclosed above for the first nine months of 2012. Included in Old National's allowance for loan losses was \$1.7 million related to the purchased loans in 2011. An immaterial amount of allowances for loan losses were reversed during 2012 and 2011 related to these loans.

**Table of Contents**

Purchased loans, both covered and noncovered, for which it was probable at acquisition that all contractually required payments would not be collected are as follows:

(dollars in thousands)	Monroe Bancorp	Integra Bank	IBT
Contractually required payments	\$ 94,714	\$ 921,856	\$ 118,535
Nonaccretable difference	(45,157)	(226,426)	(53,165)
Cash flows expected to be collected at acquisition	49,557	695,430	65,370
Accretable yield	(6,971)	(98,487)	(11,945)
Fair value of acquired loans at acquisition	\$ 42,586	\$ 596,943	\$ 53,425

Income is not recognized on certain purchased loans if Old National cannot reasonably estimate cash flows to be collected. Old National had no purchased loans for which it could not reasonably estimate cash flows to be collected.

**NOTE 9 COVERED LOANS**

Covered loans represent loans acquired from the FDIC that are subject to loss share agreements. The carrying amount of covered loans was \$448.8 million at September 30, 2012. The composition of covered loans by lending classification was as follows:

(dollars in thousands)	At September 30, 2012		
	Loans Accounted for Under ASC 310-30 (Purchased Credit Impaired)	Loans excluded from ASC 310-30 (1) (Not Purchased Credit Impaired)	Total Covered Purchased Loans
Commercial	\$ 36,803	\$ 32,698	\$ 69,501
Commercial real estate	217,289	19,824	237,113
Residential	37,266	561	37,827
Consumer	28,215	76,133	104,348
Covered loans	319,573	129,216	448,789
Allowance for loan losses	(4,334)		(4,334)
Covered loans, net	\$ 315,239	\$ 129,216	\$ 444,455

(1) Includes loans with revolving privileges which are scoped out of FASB ASC 310-30 and certain loans which Old National elected to treat under the cost recovery method of accounting.

Loans were recorded at fair value in accordance with FASB ASC 805, Business Combinations. No allowance for loan losses related to the acquired loans is recorded on the acquisition date as the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in FASB ASC 820, exclusive of the loss share agreements with the Federal Deposit Insurance Corporation ( FDIC ). The fair value estimates associated with the loans include estimates related to expected prepayments and the amount and timing of undiscounted expected principal, interest and other cash flows.

The outstanding balance of covered loans accounted for under ASC 310-30, including contractual principal, interest, fees and penalties, was \$612.9 million and \$726.8 million as of September 30, 2012 and December 31, 2011, respectively.

## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Over the life of the acquired loans, the Company continues to estimate cash flows expected to be collected on individual loans or on pools of loans sharing common risk characteristics which were treated in the aggregate when applying various valuation techniques. The Company evaluates at each balance sheet date whether the present value of its loans determined using the effective interest rates has decreased and if so, recognizes a provision for loan losses. For any increases in cash flows expected to be collected, the Company adjusts the amount of accretable yield recognized on a prospective basis over the loan's or pool's remaining life. These prospective yield adjustments are partially offset as Old National will recognize a corresponding decrease in cash flows expected from the indemnification asset prospectively in a similar manner. The indemnification asset is adjusted over the shorter of the life of the underlying investment or the indemnification agreement.

**Table of Contents**

Accretable yield, or income expected to be collected on the covered loans accounted for under ASC 310-30, is as follows:

(dollars in thousands)	
Balance at January 1, 2012	\$ 92,053
New loans purchased	
Accretion of income	(37,919)
Reclassifications from (to) nonaccretable difference	35,678
Disposals/other adjustments	411
 Balance at September 30, 2012	 \$ 90,223

At September 30, 2012, the loss sharing asset is comprised of a \$111.8 million FDIC indemnification asset and a \$15.1 million FDIC loss share receivable. The loss share receivable represents the current reimbursable amounts from the FDIC that have not yet been received. The indemnification asset represents the cash flows the Company expects to collect from the FDIC under the loss sharing agreements and the amount related to the estimated improvements in cash flow expectations that are being amortized over the same period for which those improved cash flows are being accreted into income. At September 30, 2012, \$95.0 million of the FDIC indemnification asset related to expected indemnification payments and \$16.8 million is expected to be amortized against future accreted interest income.

For covered loans, the Company remeasures contractual and expected cash flows on a quarterly basis. When the quarterly re-measurement process results in a decrease in expected cash flows due to an increase in expected credit losses, impairment is recorded. As a result of this impairment, the indemnification asset is increased to reflect anticipated future cash flows to be received from the FDIC. Consistent with the loss sharing agreements between the Company and the FDIC, the amount of the increase to the indemnification asset is measured at 80% of the resulting impairment.

Alternatively, when the quarterly re-measurement results in an increase in expected future cash flows due to a decrease in expected credit losses, the nonaccretable difference decreases and the effective yield of the related loan portfolio is increased. As a result of the improved expected cash flows, the indemnification asset would be reduced first by the amount of any impairment previously recorded and, second, by increased amortization over the remaining life of the related loss sharing agreements.

The following table shows a detailed analysis of the FDIC loss sharing asset for the nine months ended September 30, 2012:

(dollars in thousands)	
Balance at January 1, 2012	\$ 167,714
Adjustments not reflected in income:	
Established through acquisitions	
Cash received from FDIC	(36,338)
Other	(377)
Adjustments reflected in income:	
(Amortization) accretion	(10,614)
Impairment	624
Write-downs/sale of other real estate	8,517
Recovery amounts due to FDIC	(1,915)
Other	(730)
 Balance at September 30, 2012	 \$ 126,881



**Table of Contents**

Also included in Other Assets is a \$918 thousand receivable related to noninterest loan expenses that are reimbursable by the FDIC.

**NOTE 10 OTHER REAL ESTATE OWNED**

The following table shows the carrying amount for other real estate owned at September 30, 2012 and December 31, 2011:

(dollars in thousands)	Other Real Estate Owned (1)	Other Real Estate Owned, Covered
Balance, December 31, 2011	\$ 7,119	\$ 30,443
Acquired	5,597	
Additions	10,023	17,038
Sales	(6,293)	(8,109)
Gains (losses)/Write-downs	(2,164)	(10,592)
Balance, September 30, 2012	\$ 14,282	\$ 28,780

(1) Includes \$0.4 million of repossessed personal property at September 30, 2012.

Covered OREO expenses and valuation write-downs are recorded in the noninterest expense section of the consolidated statements of income. Under the loss sharing agreements, the FDIC will reimburse the Company for 80% of expenses and valuation write-downs related to covered assets up to \$275.0 million, losses in excess of \$275.0 million up to \$467.2 million at 0%, and 80% of losses in excess of \$467.2 million. As of September 30, 2012, we do not expect losses to exceed \$275.0 million. The reimbursable portion of these expenses is recorded in the FDIC indemnification asset. Changes in the FDIC indemnification asset are recorded in the noninterest income section of the consolidated statements of income.

**NOTE 11 GOODWILL AND OTHER INTANGIBLE ASSETS**

The following table shows the changes in the carrying amount of goodwill by segment for the nine months ended September 30, 2012 and 2011:

(dollars in thousands)	Community Banking	Other	Total
Balance, January 1, 2012	\$ 212,412	\$ 40,765	\$ 253,177
Goodwill acquired during the period	85,706	1,000	86,706
Balance, September 30, 2012	\$ 298,118	\$ 41,765	\$ 339,883
Balance, January 1, 2011	\$ 128,011	\$ 39,873	\$ 167,884
Goodwill acquired during the period	97,209	892	98,101
Balance, September 30, 2011	\$ 225,220	\$ 40,765	\$ 265,985

Goodwill is reviewed annually for impairment. As of August 31, 2012, Old National concluded that, based on current events and circumstances, it is not more likely than not that the carry value of goodwill exceeds fair value. Also during the third quarter of 2012, Old National recorded \$86.7 million of goodwill associated with the acquisition of Indiana Community Bancorp, of which \$85.7 million was allocated to the

Community Banking segment and \$1.0 million to the Other segment. Old National recorded \$68.4 million of goodwill in the first quarter of 2011 associated with the acquisition of Monroe Bancorp, of which \$67.5 million was allocated to the Community Banking segment and \$0.9 million to the Other segment. Old National recorded \$29.7 million of goodwill in the third quarter of 2011 associated with the acquisition of Integra Bank, all of which was allocated to the Community Banking segment. During the fourth quarter of 2011 the amount of the goodwill estimate recorded on July 29, 2011 associated with the acquisition of Integra Bank was adjusted by \$12.8 million.



**Table of Contents**

The gross carrying amount and accumulated amortization of other intangible assets at September 30, 2012 and December 31, 2011 was as follows:

(dollars in thousands)	Gross Carrying Amount	Accumulated Amortization and Impairment	Net Carrying Amount
<b>September 30, 2012</b>			
Amortized intangible assets:			
Core deposit	\$ 40,559	\$ (24,615)	\$ 15,944
Customer business relationships	26,411	(17,687)	8,724
Customer trust relationships	5,352	(886)	4,466
Customer loan relationships	4,413	(2,274)	2,139
<b>Total intangible assets</b>	<b>\$ 76,735</b>	<b>\$ (45,462)</b>	<b>\$ 31,273</b>
<b>December 31, 2011</b>			
Amortized intangible assets:			
Core deposit	\$ 39,265	\$ (20,815)	\$ 18,450
Customer business relationships	25,897	(16,312)	9,585
Customer trust relationships	3,622	(474)	3,148
Customer loan relationships	4,413	(1,972)	2,441
<b>Total intangible assets</b>	<b>\$ 73,197</b>	<b>\$ (39,573)</b>	<b>\$ 33,624</b>

Other intangible assets consist of core deposit intangibles and customer relationship intangibles and are being amortized primarily on an accelerated basis over their estimated useful lives, generally over a period of 5 to 25 years. During the third quarter of 2012, Old National increased core deposits by \$1.3 million related to the acquisition of Indiana Community Bancorp, which is included in the Community Banking segment. Also during the third quarter of 2012, Old National increased customer relationship intangibles by \$1.7 million associated with the trust business of Indiana Community Bancorp, which is included in the Other segment. During the second quarter of 2012, Old National increased customer business relationships by \$0.5 million related to the purchase of an insurance book of business, which is included in the Other segment. During the first quarter of 2011, Old National recorded \$8.2 million of core deposit intangibles associated with the acquisition of Monroe Bancorp, which is included in the Community Banking segment. During the first quarter of 2011, Old National also recorded \$2.3 million of customer relationship intangibles associated with the trust business of Monroe Bancorp, which is included in the Other segment. During the second quarter of 2011, Old National recorded \$1.3 million of customer relationship intangibles associated with the trust business of Integra Wealth Management and Trust, which is included in the Other segment. During the second quarter of 2011, Old National reduced customer business relationships by \$0.1 million related to the sale of an insurance book of business, which is included in the Other segment. During the third quarter of 2011, Old National recorded \$4.3 million of core deposit intangibles associated with the acquisition of Integra Bank, which is included in the Community Banking segment. During the fourth quarter of 2011, Old National recorded \$0.3 million of customer business relationships associated with the purchase of an insurance book of business and took accelerated amortization of \$0.7 million on its core deposit intangible related to the sale of the former Chicago-area Integra branches. Total amortization expense associated with other intangible assets for the nine months ended September 30 was \$5.9 million in 2012 and \$ 5.9 million in 2011.

Estimated amortization expense for future years is as follows:

(dollars in thousands)	
2012 remaining	\$ 2,053
2013	7,714
2014	5,800
2015	4,688
2016	3,767
Thereafter	7,251

Total	\$ 31,273
-------	-----------

**Table of Contents****NOTE 12 SHORT-TERM BORROWINGS**

The following table presents the distribution of Old National's short-term borrowings and related weighted-average interest rates as of September 30, 2012:

(dollars in thousands)	Federal Funds Purchased	Repurchase Agreements	Other Short-term Borrowings	Total
<b>2012</b>				
Outstanding at September 30, 2012	\$ 117,515	\$ 334,545	\$	\$ 452,060
Average amount outstanding	67,139	315,226	12	382,377
Maximum amount outstanding at any month-end	231,202	345,081		
Weighted average interest rate:				
During nine months ended September 30, 2012	0.15%	0.12%	7.53%	0.13%
At September 30, 2012	0.13	0.30		0.26

**Other Short-term Borrowings**

At December 31, 2011, Old National had a \$114 thousand note payable to a life insurance company which was assumed as part of the Integra Bank acquisition and matured in January 2012. This note payable carried an effective interest rate of 7.26%.

**NOTE 13 FINANCING ACTIVITIES**

The following table summarizes Old National's and its subsidiaries' other borrowings at September 30, 2012 and December 31, 2011:

(dollars in thousands)	September 30, 2012	December 31, 2011
<b>Old National Bancorp:</b>		
Junior subordinated debenture (variable rates of 1.96% to 2.11%) maturing March 2035 to June 2037	\$ 28,000	\$ 16,000
Subordinated notes (fixed rate of 10.00%) maturing June 2019		13,000
ASC 815 fair value hedge and other basis adjustments	(3,357)	(3,003)
<b>Old National Bank:</b>		
Securities sold under agreements to repurchase (variable rates 3.62% to 3.82%) maturing October 2014	50,000	50,000
Federal Home Loan Bank advances (fixed rates 1.24% to 8.34% and variable rate 2.75%) maturing April 2013 to January 2023	206,980	208,360
Capital lease obligation	4,224	4,261
ASC 815 fair value hedge and other basis adjustments	2,655	2,156
Total other borrowings	\$ 288,502	\$ 290,774

**Table of Contents**

Contractual maturities of other borrowings at September 30, 2012, were as follows:

(dollars in thousands)	
Due in 2012	\$ 13
Due in 2013	75,362
Due in 2014	92,528
Due in 2015	16,763
Due in 2016	17,413
Thereafter	87,125
ASC 815 fair value hedge and other basis adjustments	(702)
 Total	 \$ 288,502

**FEDERAL HOME LOAN BANK**

Federal Home Loan Bank advances had weighted-average rates of 3.29% and 3.30% at September 30, 2012, and December 31, 2011, respectively. These borrowings are collateralized by investment securities and residential real estate loans up to 145% of outstanding debt.

**SUBORDINATED NOTES**

In 2011, Old National acquired Monroe Bancorp. Included in the acquisition was \$13 million of 10% subordinated notes. As shown in the table above, these subordinated notes were due to mature June 2019. Old National redeemed the notes, in whole, on June 30, 2012.

**JUNIOR SUBORDINATED DEBENTURES**

Junior subordinated debentures related to trust preferred securities are classified in other borrowings. These securities qualify as Tier 1 capital for regulatory purposes, subject to certain limitations.

ONB Capital Trust II issued \$100 million in preferred securities in April 2002. Old National guaranteed the payment of distributions on the trust preferred securities issued by ONB Capital Trust II. The preferred securities had a liquidation amount of \$25 per share with a cumulative annual distribution rate of 8.0% or \$2.00 per share payable quarterly and maturing on April 15, 2032. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by ONB Capital Trust II. On November 9, 2010, Old National's Board of Directors approved the redemption of the junior subordinated debentures. As a result of the redemption of the debentures, the trustee of ONB Capital Trust II redeemed all \$100 million of the 8% trust preferred securities on December 15, 2010. The \$3.0 million remaining balance of the unamortized issuance costs at the time of the redemption were expensed.

In 2007, Old National acquired St. Joseph Capital Trust I and St. Joseph Capital Trust II in conjunction with its acquisition of St. Joseph Capital Corporation. Old National guarantees the payment of distributions on the trust preferred securities issued by St. Joseph Capital Trust I and St. Joseph Capital Trust II. St. Joseph Capital Trust I issued \$3.0 million in preferred securities in July 2003. The preferred securities carried a variable rate of interest priced at the three-month LIBOR plus 305 basis points, payable quarterly and maturing on July 11, 2033. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by St. Joseph Capital Trust I. Old National redeemed these junior subordinated notes as of June 30, 2012. As a result of the redemption of the junior subordinated notes, the trustee of St. Joseph Capital Trust I redeemed all \$3.0 million of its preferred securities. St. Joseph Capital Trust II issued \$5.0 million in preferred securities in March 2005. The preferred securities had a cumulative annual distribution rate of 6.27% until March 2010 and now carry a variable rate of interest priced at the three-month LIBOR plus 175 basis points, payable quarterly and maturing on March 17, 2035. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by St. Joseph Capital Trust II. Old National, at any time, may redeem the junior subordinated debentures and thereby cause a redemption of the trust preferred securities.

**Table of Contents**

In 2011, Old National acquired Monroe Bancorp Capital Trust I and Monroe Bancorp Statutory Trust II in conjunction with its acquisition of Monroe Bancorp. Old National guarantees the payment of distributions on the trust preferred securities issued by Monroe Bancorp Capital Trust I and Monroe Bancorp Statutory Trust II. Monroe Bancorp Capital Trust I issued \$3.0 million in preferred securities in July 2006. The preferred securities carried a fixed rate of interest of 7.15% until October 7, 2011 and thereafter a variable rate of interest priced at the three-month LIBOR plus 160 basis points. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by Monroe Bancorp Capital Trust I. Monroe Bancorp Statutory Trust II issued \$5.0 million in preferred securities in March 2007. The preferred securities carried a fixed rate of interest of 6.52% until June 15, 2012 and thereafter a variable rate of interest priced at the three-month LIBOR plus 160 basis points. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by Monroe Bancorp Statutory Trust II. Old National, at any time, may redeem the junior subordinated debentures and thereby cause a redemption of the trust preferred securities in whole or in part.

In 2012, Old National acquired Home Federal Statutory Trust I in conjunction with its acquisition of Indiana Community Bancorp. Old National guarantees the payment of distributions on the trust preferred securities issued by Home Federal Statutory Trust I. Home Federal Statutory Trust I issued \$15.0 million in preferred securities in September 2006. The preferred securities carry a variable rate of interest priced at the three-month LIBOR plus 165 basis points. Proceeds from the issuance of these securities were used to purchase junior subordinated debentures with the same financial terms as the securities issued by Home Federal Statutory Trust I. Old National, at any time, may redeem the junior subordinated debentures and thereby cause a redemption of the trust preferred securities in whole or in part.

**CAPITAL LEASE OBLIGATION**

On January 1, 2004, Old National entered into a long-term capital lease obligation for a branch office building in Owensboro, Kentucky, which extends for 25 years with one renewal option for 10 years. The economic substance of this lease is that Old National is financing the acquisition of the building through the lease and accordingly, the building is recorded as an asset and the lease is recorded as a liability. The fair value of the capital lease obligation was estimated using a discounted cash flow analysis based on Old National's current incremental borrowing rate for similar types of borrowing arrangements.

At September 30, 2012, the future minimum lease payments under the capital lease were as follows:

(dollars in thousands)	
2012 remaining	\$ 97
2013	390
2014	410
2015	410
2016	410
Thereafter	10,084
<b>Total minimum lease payments</b>	<b>11,801</b>
Less amounts representing interest	7,577
<b>Present value of net minimum lease payments</b>	<b>\$ 4,224</b>

**NOTE 14 EMPLOYEE BENEFIT PLANS****RETIREMENT PLAN**

Old National maintains a funded noncontributory defined benefit plan (the Retirement Plan) that was frozen as of December 31, 2005. Retirement benefits are based on years of service and compensation during the highest paid five years of employment. The freezing of the plan provides that future salary increases will not be considered. Old National's policy is to contribute at least the minimum funding requirement determined by the plan's actuary. Old National expects to contribute approximately \$199 thousand to the Retirement Plan in 2012.

**Table of Contents**

Old National also maintains an unfunded pension restoration plan (the Restoration Plan) which provides benefits for eligible employees that are in excess of the limits under Section 415 of the Internal Revenue Code of 1986, as amended, that apply to the Retirement Plan. The Restoration Plan is designed to comply with the requirements of ERISA. The entire cost of the plan, which was also frozen as of December 31, 2005, is supported by contributions from the Company.

Old National contributed \$135 thousand to cover benefit payments from the Restoration Plan during the first nine months of 2012. Old National expects to contribute an additional \$30 thousand to cover benefit payments from the Restoration Plan during the remainder of 2012.

The net periodic benefit cost and its components were as follows for the three and nine months ended September 30:

(dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Interest cost	\$ 494	\$ 525	\$ 1,480	\$ 1,575
Expected return on plan assets	(587)	(676)	(1,760)	(2,028)
Recognized actuarial loss	1,007	689	3,020	2,067
Settlement		465		1,069
<b>Net periodic benefit cost</b>	<b>\$ 914</b>	<b>\$ 1,003</b>	<b>\$ 2,740</b>	<b>\$ 2,683</b>

On September 15, 2012, Old National assumed Indiana Bank and Trust's Pentegra Defined Benefit Plan for Financial Institutions. This defined benefit pension plan has been frozen since April 1, 2008. The trustees of the Financial Institutions Retirement Fund administer the Pentegra Plan, employer identification number 13-5645888 and plan number 333. The Pentegra Plan operates as a multi-employer plan for accounting purposes and as a multiple-employer plan under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. Old National has given notice to withdraw from the plan, effective December 31, 2012, and has recorded an estimated \$11.7 million termination liability in Accrued Expenses and Other Liabilities. This purchase accounting entry increased goodwill by \$7.1 million after tax.

**NOTE 15 STOCK-BASED COMPENSATION**

At September 30, 2012, Old National had 3.5 million shares remaining available for issuance under the Company's Amended and Restated 2008 Incentive Compensation Plan. The granting of awards to key employees is typically in the form of restricted stock or options to purchase common shares of stock.

*Stock Options*

The Company did not grant any stock options during the first nine months of 2012. Old National recorded \$6 thousand of stock based compensation expense, net of tax, during the first nine months of 2012 as compared to \$61 thousand for the first nine months of 2011.

In connection with the acquisition of Indiana Community Bancorp on September 15, 2012, 0.2 million options for shares of Indiana Community Bancorp stock were converted to 0.3 million options for shares of Old National Bancorp stock. Old National recorded no incremental expense associated with the conversion of these options. In connection with the acquisition of Monroe Bancorp on January 1, 2011, 0.3 million options for shares of Monroe Bancorp stock were converted to 0.3 million options for shares of Old National Bancorp stock. Old National recorded no incremental expense associated with the conversion of these options.

*Restricted Stock Awards*

The Company granted 62 thousand time-based restricted stock awards to certain key officers during the first nine months of 2012, with shares vesting at the end of a thirty-six month period. Compensation expense is recognized on a straight-line basis over the vesting period. Shares are subject to certain restrictions and risk of forfeiture by the participants. As of September 30, 2012, unrecognized compensation expense was estimated to be \$1.3 million for unvested restricted share awards.





**Table of Contents**

Old National recorded expense of \$0.3 million, net of tax, during the first nine months of 2012, compared to expense of \$0.7 million during the first nine months of 2011 related to the vesting of restricted share awards. Included in the first nine months of 2012 is the reversal of \$0.4 million of expense associated with certain performance-based restricted stock grants.

During the third quarter of 2011, the Company modified the vesting eligibility of 10 thousand shares of restricted stock issued to an employee. As a result of that modification, the Company reversed \$0.1 million for the quarter ended September 30, 2011. There were no modifications in 2012 that resulted in incremental expense.

In connection with the acquisition of Indiana Community Bancorp on September 15, 2012, 15 thousand unvested Indiana Community Bancorp restricted stock awards were converted to 29 thousand unvested Old National restricted stock awards. These restricted stock awards will continue to vest based on the conditions in the original award agreements.

*Restricted Stock Units*

The Company granted 218 thousand shares of performance based restricted stock units to certain key officers during the first nine months of 2012, with shares vesting at the end of a thirty-six month period based on the achievement of certain targets. Compensation expense is recognized on a straight-line basis over the vesting period. Shares are subject to certain restrictions and risk of forfeiture by the participants. In addition, certain of the restricted stock units are subject to relative performance factors which could increase or decrease the percentage of shares issued.

Old National recorded \$1.1 million of stock based compensation expense, net of tax, during the first nine months of 2012. Old National recorded \$0.8 million of stock based compensation expense, net of tax, during the first nine months of 2011. Included in the first nine months of 2012 is the reversal of \$20 thousand of expense associated with certain performance-based restricted stock grants. Included in the first nine months of 2011 is the reversal of \$13 thousand of expense associated with certain performance-based restricted stock grants.

**NOTE 16 INCOME TAXES**

Following is a summary of the major items comprising the differences in taxes from continuing operations computed at the federal statutory rate and as recorded in the consolidated statement of income for the three and nine months ended September 30:

(dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Provision at statutory rate of 35%	\$ 8,960	\$ 8,695	\$ 32,815	\$ 24,058
Tax-exempt income	(2,732)	(2,421)	(7,878)	(7,182)
Reversal of portion of unrecognized tax benefits	(292)	(623)	(292)	(623)
State income taxes	249	1,196	2,276	2,292
Interim period effective rate adjustment	(87)	888	(793)	89
Other, net	(237)	310	(1,038)	(144)
<b>Income tax expense</b>	<b>\$ 5,861</b>	<b>\$ 8,045</b>	<b>\$ 25,090</b>	<b>\$ 18,490</b>
Effective tax rate	<b>22.9%</b>	32.4%	<b>26.8%</b>	26.9%

In accordance with ASC 740-270, Accounting for Interim Reporting, the provision for income taxes was recorded at September 30, 2012 and 2011 based on the current estimate of the effective annual rate.

The decrease in the quarterly comparison is primarily a result of adjustments to our state income tax apportionment rates due to the effect of acquisitions. For the nine months ended September 30, 2012, the effective tax rate was effectively the same as the nine months ended September 30, 2011.



**Table of Contents**

No valuation allowance was recorded at September 30, 2012 and 2011 because, based on our current expectations, Old National believes that it will generate sufficient income in the future years to realize deferred tax assets.

**Unrecognized Tax Benefits**

The Company and its subsidiaries file a consolidated U.S. federal income tax return, as well as filing various state returns. Unrecognized state income tax benefits are reported net of their related deferred federal income tax benefit.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

(dollars in thousands)	2012	2011
Balance at January 1	\$ 4,145	\$ 4,553
Additions (reductions) based on tax positions related to the current year	1	4
Reductions due to statute of limitations expiring	(194)	(413)
Balance at September 30	\$ 3,952	\$ 4,144

Approximately \$0.16 million of unrecognized tax benefits, if recognized, would favorably affect the effective income tax rate in future periods.

The Company reversed \$0.29 million, including interest of \$0.1 million not included in the table above, related to uncertain tax positions accounted for under FASB ASC 740-10 (FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*). The positive \$0.29 million income tax reversal relates to the 2008 statute of limitations expiring. The statute of limitations expired in the third quarter of 2012. As a result, the Company reversed a total of \$0.29 million from its unrecognized tax benefit liability which includes \$0.1 million of interest.

**NOTE 17 DERIVATIVE FINANCIAL INSTRUMENTS**

As part of the Company's overall interest rate risk management, Old National uses derivative instruments, including interest rate swaps, caps and floors. The notional amount of these derivative instruments was \$92.5 million and \$192.5 million at September 30, 2012 and December 31, 2011, respectively. The September 30, 2012 balances consist of \$92.5 million notional amount of receive-fixed interest rate swaps on certain of its FHLB advances. The December 31, 2011 balances consist of \$92.5 million notional amount of receive-fixed interest rate swaps on certain of its FHLB advances and \$100.0 million notional amount of receive-fixed interest rate swaps on certain commercial loans. These hedges were entered into to manage both interest rate risk and asset sensitivity on the balance sheet. These derivative instruments are recognized on the balance sheet at their fair value.

In addition, commitments to fund certain mortgage loans (interest rate lock commitments) and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. At September 30, 2012, the notional amount of the interest rate lock commitments and forward commitments were \$12.5 million and \$16.7 million, respectively. At December 31, 2011, the notional amount of the interest rate lock commitments and forward commitments were \$8.7 million and \$10.2 million, respectively. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans to third party investors when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from its commitment to fund the loans. All derivative instruments are recognized on the balance sheet at their fair value.

Old National also enters into derivative instruments for the benefit of its customers. The notional amounts of these customer derivative instruments and the offsetting counterparty derivative instruments were \$440.1 million and \$440.1 million, respectively, at September 30, 2012. At December 31, 2011, the notional amounts of the customer derivative instruments and the offsetting counterparty derivative instruments were \$448.5 million and \$448.5 million, respectively. These derivative contracts do not qualify for hedge accounting. These instruments include interest rate swaps, caps, foreign exchange forward contracts and commodity swaps and options. Commonly, Old National will economically hedge significant exposures related to these derivative contracts entered into for the benefit of customers by entering into offsetting contracts with approved, reputable, independent counterparties with substantially matching terms.

**Table of Contents**

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. Old National's exposure is limited to the replacement value of the contracts rather than the notional, principal or contract amounts. There are provisions in our agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, the Company minimizes credit risk through credit approvals, limits, and monitoring procedures.

The following tables summarize the fair value of derivative financial instruments utilized by Old National:

	Asset Derivatives			
	September 30, 2012		December 31, 2011	
(dollars in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>Derivatives designated as hedging instruments</b>				
Interest rate contracts	Other assets	\$ 7,590	Other assets	\$ 7,444
<b>Total derivatives designated as hedging instruments</b>		<b>\$ 7,590</b>		<b>\$ 7,444</b>
<b>Derivatives not designated as hedging instruments</b>				
Interest rate contracts	Other assets	\$ 32,450	Other assets	\$ 36,755
Mortgage contracts	Other assets	375	Other assets	216
<b>Total derivatives not designated as hedging instruments</b>		<b>\$ 32,825</b>		<b>\$ 36,971</b>
Total derivative assets		<b>\$ 40,415</b>		<b>\$ 44,415</b>

	Liability Derivatives			
	September 30, 2012		December 31, 2011	
(dollars in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>Derivatives not designated as hedging instruments</b>				
Interest rate contracts	Other liabilities	\$ 32,967	Other liabilities	\$ 37,332
Mortgage contracts	Other liabilities	84	Other liabilities	
<b>Total derivatives not designated as hedging instruments</b>		<b>\$ 33,051</b>		<b>\$ 37,332</b>
Total derivative liabilities		<b>\$ 33,051</b>		<b>\$ 37,332</b>

**Table of Contents**

The effect of derivative instruments on the Consolidated Statement of Income for the three and nine months ended September 30, 2012 and 2011 are as follows:

(dollars in thousands)		Three months ended September 30, 2012	Three months ended September 30, 2011
<b>Derivatives in Fair Value Hedging Relationships</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>
Interest rate contracts (1)	Interest income / (expense)	\$ 508	\$ 744
Interest rate contracts (2)	Other income / (expense)	203	345
<b>Total</b>		<b>\$ 711</b>	<b>\$ 1,089</b>

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>
Interest rate contracts (1)	Interest income / (expense)	\$	\$ 410
<b>Total</b>		<b>\$</b>	<b>\$ 410</b>

<b>Derivatives Not Designated as Hedging Instruments</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>
Interest rate contracts (3)	Other income / (expense)	\$ 23	\$ (196)
Mortgage contracts	Mortgage banking revenue	(19)	(47)
<b>Total</b>		<b>\$ 4</b>	<b>\$ (243)</b>

(dollars in thousands)		Nine months ended September 30, 2012	Nine months ended September 30, 2011
<b>Derivatives in Fair Value Hedging Relationships</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>
Interest rate contracts (1)	Interest income / (expense)	\$ 1,681	\$ 2,205
Interest rate contracts (2)	Other income / (expense)	596	714
<b>Total</b>		<b>\$ 2,277</b>	<b>\$ 2,919</b>

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>
Interest rate contracts (1)	Interest income / (expense)	\$ 241	\$ 1,197
<b>Total</b>		<b>\$ 241</b>	<b>\$ 1,197</b>

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative	
Interest rate contracts (3)	Other income / (expense)	\$ 61	\$ (12)
Mortgage contracts	Mortgage banking revenue	75	(68)
<b>Total</b>		<b>\$ 136</b>	<b>\$ (80)</b>

- (1) Amounts represent the net interest payments as stated in the contractual agreements.  
(2) Amounts represent ineffectiveness on derivatives designated as fair value hedges.  
(3) Includes the valuation differences between the customer and offsetting counterparty swaps.  
See Note 21 to the consolidated financial statements.

---

**Table of Contents**

**NOTE 18 COMMITMENTS AND CONTINGENCIES**

**LITIGATION**

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

Old National contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, Old National cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, or other relief, if any, might be. Subject to the foregoing, Old National believes, based on current knowledge and after consultation with counsel, that the outcome of such pending matters will not have a material adverse effect on the consolidated financial condition of Old National, although the outcome of such matters could be material to Old National's operating results and cash flows for a particular future period, depending on, among other things, the level of Old National's revenues or income for such period. Old National will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated.

In November 2002, several beneficiaries of certain trusts filed a complaint against Old National and Old National Trust Company in the United States District Court for the Western District of Kentucky relating to the administration of the trusts in 1997. This litigation was fully and finally settled in the first quarter of 2012. The Company had previously accrued \$2 million in the third quarter of 2011 in anticipation of negotiating the final settlement and resolution of the matter. The matter was fully settled for the amount of the accrual. However, a portion of the settlement funds were put temporarily in escrow to account for uncertain contingencies. These funds, less contingencies (if any), will be released to the beneficiaries in December 2012 pursuant to the terms of the settlement agreement.

In November 2010, Old National was named in a class action lawsuit challenging Old National Bank's checking account practices associated with the assessment of overdraft fees. On May 1, 2012, the plaintiff was granted permission to file a First Amended Complaint which names additional plaintiffs and amends certain claims. The plaintiffs seek damages and other relief, including restitution. Old National believes it has meritorious defenses to the claims brought by the plaintiffs. At this phase of the litigation, it is not possible for management of Old National to determine the probability of a material adverse outcome or reasonably estimate the amount of any loss. No class has yet been certified and discovery is ongoing. On June 13, 2012, Old National filed a motion to dismiss the First Amended Complaint, which has not yet been ruled upon. On September 7, 2012, the plaintiffs filed a motion for class certification.

**LEASES**

Old National rents certain premises and equipment under operating leases, which expire at various dates. Many of these leases require the payment of property taxes, insurance premiums, maintenance and other costs. In some cases, rentals are subject to increase in relation to a cost-of-living index.

In prior periods, Old National entered into sale leaseback transactions for four office buildings in downtown Evansville, Indiana and eighty-eight financial centers. The properties sold had a carrying value of \$163.6 million. Old National received cash proceeds of approximately \$287.4 million, net of selling costs, resulting in a gain of approximately \$123.9 million. Approximately \$119.5 million of the gain was deferred and is being recognized over the term of the leases. As of September 30, 2012, \$33.7 million of the deferred gain had been recognized. The leases have original terms ranging from five to twenty-four years, and Old National has the right, at its option, to extend the term of certain of the leases for four additional successive terms of five years. Under the lease agreements, Old National is obligated to pay base rents of approximately \$25.2 million per year.

In March 2009, Old National acquired the Indiana retail branch banking network of Citizens Financial Group. The network included 65 leased locations. As of September 30, 2012, Old National had closed 24 of these locations and terminated the leases. The leases have terms of less than one year to ten years. Under the remaining lease agreements, Old National is obligated to pay a base rent of approximately \$2.2 million per year.



## **Table of Contents**

In January 2011, Old National acquired Monroe Bancorp. Included in the acquisition are two leased branches, a leased operations center, five leased ATM locations and leased space in three retirement centers. The leased space in one of the retirement centers was closed in the second quarter of 2011. The leases have terms of one to five years. Under the remaining lease agreements, Old National is obligated to pay a base rent of approximately \$0.3 million per year.

On July 29, 2011, Old National acquired the banking operations of Integra Bank N.A. ( Integra ) in an FDIC assisted transaction. Rent expense of \$2.0 million was recorded during 2011 related to the leased properties prior to their closure. None of the remaining facilities are leased.

On September 15, 2012, Old National acquired Indiana Community Bancorp. Included in the acquisition are two leased branches, a leased commercial loan office and leased space in a retirement center. One of the leased branches was closed in September 2012. The leases on the remaining leased branch and commercial loan office have terms of 4.5 years and 8.5 years. Under the remaining lease agreements, Old National is obligated to pay a base rent of approximately \$0.2 million per year.

## **CREDIT-RELATED FINANCIAL INSTRUMENTS**

In the normal course of business, Old National's banking affiliates have entered into various agreements to extend credit, including loan commitments of \$1.339 billion and standby letters of credit of \$69.4 million at September 30, 2012. At September 30, 2012, approximately \$1.281 billion of the loan commitments had fixed rates and \$58 million had floating rates, with the floating interest rates ranging from 0% to 21%. At December 31, 2011, loan commitments were \$1.220 billion and standby letters of credit were \$73.3 million. These commitments are not reflected in the consolidated financial statements. At September 30, 2012 and December 31, 2011, the balance of the allowance for unfunded loan commitments was \$8.0 million and \$4.8 million, respectively.

At September 30, 2012 and December 31, 2011, Old National had credit extensions of \$17.3 million and \$24.2 million, respectively, with various unaffiliated banks related to letter of credit commitments issued on behalf of Old National's clients. At September 30, 2012 and December 31, 2011, Old National provided collateral to the unaffiliated banks to secure credit extensions totaling \$13.6 million and \$17.5 million, respectively. Old National did not provide collateral for the remaining credit extensions.

## **NOTE 19 FINANCIAL GUARANTEES**

Old National holds instruments, in the normal course of business with clients, that are considered financial guarantees in accordance with FASB ASC 460-10 (FIN 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*), which requires the Company to record the instruments at fair value. Standby letters of credit guarantees are issued in connection with agreements made by clients to counterparties. Standby letters of credit are contingent upon failure of the client to perform the terms of the underlying contract. Credit risk associated with standby letters of credit is essentially the same as that associated with extending loans to clients and is subject to normal credit policies. The term of these standby letters of credit is typically one year or less. At September 30, 2012, the notional amount of standby letters of credit was \$69.4 million, which represents the maximum amount of future funding requirements, and the carrying value was \$0.4 million. At December 31, 2011, the notional amount of standby letters of credit was \$73.3 million, which represents the maximum amount of future funding requirements, and the carrying value was \$0.4 million.

During the second quarter of 2007, Old National entered into a risk participation in an interest rate swap. The interest rate swap had a notional amount of \$8.7 million at September 30, 2012.

**Table of Contents****NOTE 20 SEGMENT INFORMATION**

Old National operates in two operating segments: community banking and treasury. The community banking segment serves customers in both urban and rural markets providing a wide range of financial services including commercial, real estate and consumer loans; lease financing; checking, savings, time deposits and other depository accounts; cash management services; and debit cards and other electronically accessed banking services and Internet banking. Treasury manages investments, wholesale funding, interest rate risk, liquidity and leverage for Old National. Additionally, treasury provides other miscellaneous capital markets products for its corporate banking clients. Other is comprised of the parent company and several smaller business units including insurance, wealth management and brokerage. It includes unallocated corporate overhead and intersegment revenue and expense eliminations.

In order to measure performance for each segment, Old National allocates capital and corporate overhead to each segment. Capital and corporate overhead are allocated to each segment using various methodologies, which are subject to periodic changes by management. Intersegment sales and transfers are not significant.

Old National uses a funds transfer pricing ( FTP ) system to eliminate the effect of interest rate risk from net interest income in the community banking segment and from companies included in the other column. The FTP system is used to credit or charge each segment for the funds the segments create or use. The net FTP credit or charge is reflected in segment net interest income.

The financial information for each operating segment is reported on the basis used internally by Old National's management to evaluate performance and is not necessarily comparable with similar information for any other financial institution.

Summarized financial information concerning segments is shown in the following table for the three and nine months ended September 30:

(dollars in thousands)	Community Banking	Treasury	Other	Total
<b>Three months ended September 30, 2012</b>				
Net interest income	\$ 69,613	\$ (6,731)	\$ 11,268	\$ 74,150
Provision for loan losses	301		99	400
Noninterest income	27,785	4,456	8,626	40,867
Noninterest expense	67,085	2,616	19,318	89,019
Income (loss) before income taxes	30,012	(4,891)	477	25,598
Total assets	5,463,149	3,460,547	459,348	9,383,044
<b>Three months ended September 30, 2011</b>				
Net interest income	\$ 75,292	\$ (11,803)	\$ 9,103	\$ 72,592
Provision for loan losses	(1,258)		1,176	(82)
Noninterest income	28,800	4,756	13,770	47,326
Noninterest expense	60,828	8,840	25,490	95,158
Income (loss) before income taxes	44,522	(15,887)	(3,793)	24,842
Total assets	5,156,030	3,569,790	206,880	8,932,700
<b>Nine months ended September 30, 2012</b>				
Net interest income	\$ 205,911	\$ (18,629)	\$ 37,114	\$ 224,396
Provision for loan losses	(3,419)		6,268	2,849
Noninterest income	81,733	14,831	41,978	138,542
Noninterest expense	189,909	7,059	69,365	266,333
Income (loss) before income taxes	101,154	(10,857)	3,459	93,756
Total assets	5,463,149	3,460,547	459,348	9,383,044
<b>Nine months ended September 30, 2011</b>				
Net interest income	\$ 218,356	\$ (30,009)	\$ 7,931	\$ 196,278
Provision for loan losses	5,261		1,176	6,437
Noninterest income	80,989	8,816	43,931	133,736
Noninterest expense	192,071	10,617	52,153	254,841

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Income (loss) before income taxes	102,013	(31,810)	(1,467)	68,736
Total assets	5,156,030	3,569,790	206,880	8,932,700

---

## **Table of Contents**

Old National had two acquisitions in the periods presented: Integra Bank on July 29, 2011 and Indiana Community Bancorp ( IBT ) on September 15, 2012.

Included in net interest income for the three and nine months ended September 30, 2012 in the Community Banking segment is approximately \$5.6 million and \$18.9 million, respectively, and in the Other segment is approximately \$8.9 million and \$28.1 million, respectively, associated with the acquisition of Integra Bank.

Noninterest expense for the three and nine months ended September 30, 2012 includes \$1.0 million and \$6.1 million, respectively, of costs in the Community Banking segment and \$1.3 million and \$13.1 million, respectively, of costs in the Other segment associated with the addition of Integra Bank. Also included in noninterest expense for the three and nine months ended September 30, 2012 is \$5.3 million and \$6.3 million, respectively, of costs in the Community Banking segment and \$0.2 million and \$0.2 million, respectively, of costs in the Other segment associated with the acquisition and integration of IBT.

### **NOTE 21 FAIR VALUE**

FASB ASC 820-10 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820-10 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

Level 1 Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or 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.

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

**Trading securities:** The fair value for trading securities is determined by quoted market prices (Level 1).

**Investment securities:** The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities 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). Discounted cash flows are calculated using swap and libor curves plus spreads that adjust for loss severities, volatility, credit risk and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

**Residential 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 financial instruments:** The fair values of derivative financial instruments are based on derivative valuation models using market data inputs as of the valuation date (Level 2).

**Table of Contents**

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

(dollars in thousands)	Carrying Value	Fair Value Measurements at September 30, 2012 Using Significant		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial Assets</b>				
Trading securities	\$ 3,043	\$ 3,043	\$	\$
Investment securities available-for-sale:				
U.S. Treasury	15,585	15,585		
U.S. Government-sponsored entities and agencies	387,176		387,176	
Mortgage-backed securities Agency	1,139,947		1,139,947	
Mortgage-backed securities Non-agency	32,724		32,724	
States and political subdivisions	557,835		556,853	982
Pooled trust preferred securities	9,094			9,094
Other securities	170,428		170,428	
Residential loans held for sale	9,911		9,911	
Derivative assets	40,415		40,415	
<b>Financial Liabilities</b>				
Derivative liabilities	33,051		33,051	

(dollars in thousands)	Carrying Value	Fair Value Measurements at December 31, 2011 Using Significant		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial Assets</b>				
Trading securities	\$ 2,816	\$ 2,816	\$	\$
Investment securities available-for-sale:				
U.S. Treasury	65,769	65,769		
U.S. Government-sponsored entities and agencies	173,185		173,185	
Mortgage-backed securities Agency	1,182,255		1,182,255	
Mortgage-backed securities Non-agency	85,900		85,900	
States and political subdivisions	402,844		401,538	1,306
Pooled trust preferred securities	7,327			7,327
Other securities	153,996		153,996	
Residential loans held for sale	4,528		4,528	
Derivative assets	44,415		44,415	
<b>Financial Liabilities</b>				
Derivative liabilities	37,332		37,332	

**Table of Contents**

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2012:

(dollars in thousands)	Fair Value Measurements using Significant Unobservable Inputs (Level 3)	
	Pooled Trust Preferred Securities Available- for-Sale	State and Political Subdivisions
Beginning balance, January 1, 2012	\$ 7,327	\$ 1,306
Accretion/(amortization) of discount or premium	13	5
Payments received	(66)	
Matured securities		(329)
Credit loss write-downs	(165)	
Increase/(decrease) in fair value of securities	1,985	
Ending balance, September 30, 2012	\$ 9,094	\$ 982

Included in the income statement are \$18 thousand of income included in interest income from the accretion of discounts on securities and \$165 thousand of credit losses included in noninterest income. The increase in fair value is reflected in the balance sheet as an increase in the fair value of investment securities available-for sale, an increase in accumulated other comprehensive income, which is included in shareholders equity, and a decrease in other assets related to the tax impact.

\$1.3 million of state and political subdivision securities were transferred to Level 3 as of December 31, 2011 because Old National could no longer obtain evidence of observable inputs. There have been no transfers to Level 3 in 2012.

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2011:

(dollars in thousands)	Fair Value Measurements using Significant Unobservable Inputs (Level 3)	
	Pooled Trust Preferred Securities Available- for-Sale	
Beginning balance, January 1, 2011	\$ 8,400	
Accretion/(amortization) of discount or premium	(49)	
Payments received	(5)	
Credit loss write-downs		
Increase/(decrease) in fair value of securities	(816)	
Ending balance, September 30, 2011	\$ 7,530	

Included in the income statement is \$49 thousand of expense included in interest income from the amortization of premiums on securities. The decrease in fair value is reflected in the balance sheet as a decrease in the fair value of investment securities available-for sale, a decrease in accumulated other comprehensive income, which is included in shareholders equity, and an increase in other assets related to the tax impact.



**Table of Contents**

The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy:

Quantitative Information about Level 3 Fair Value Measurements				
(dollars in thousands)	Fair Value at Sept. 30, 2012	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Pooled trust preferred securities	\$ 9,094	Discounted cash flow	Constant prepayment rate (a)	0.00%
			Additional asset defaults (b)	1% - 32% (8%)
			Expected asset recoveries (c)	3% - 21% (14%)
State and political subdivision securities	982	Discounted cash flow	No unobservable inputs	NA
			Illiquid local municipality issuance	
			Old National owns 100%	
			Carried at par	

- (a) Assuming no prepayments.
- (b) Each currently performing pool asset is assigned a default probability based on the banking environment, which is adjusted for specific issuer evaluation, of 0%, 50% or 100%.
- (c) Each currently defaulted pool asset is assigned a recovery probability based on specific issuer evaluation of 0%, 25% or 100%.

The significant unobservable inputs used in the fair value measurement for pooled trust preferred securities are prepayment rates, assumed additional pool asset defaults and expected return to performing status of defaulted pool assets. Significant changes in any of the inputs in isolation would result in a significant change to the fair value measurement. Seven of the nine pooled trust preferred securities Old National owns are subordinate note classes that rely on an ongoing cash flow stream to support their values. The senior note classes receive the benefit of prepayments to the detriment of subordinate note classes since the ongoing interest cash flow stream is reduced by the early redemption. Generally, a change in prepayment rates or additional pool asset defaults has an impact that is directionally opposite from a change in the expected recovery of a defaulted pool asset.

Assets measured at fair value on a non-recurring basis are summarized below:

(dollars in thousands)	Fair Value Measurements at September 30, 2012 Using Quoted Prices in			
	Carrying Value	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Collateral Dependent Impaired Loans</b>				
Commercial loans	\$ 18,230			\$ 18,230
Commercial real estate loans	14,196			14,196
<b>Foreclosed Assets</b>				
Commercial real estate	2,545			2,545
Residential	83			83

Impaired commercial and commercial real estate loans that are deemed collateral dependent are valued based on the fair value of the underlying collateral. These estimates are based on the most recently available appraisals with certain adjustments made based on the type of property, age of appraisal, current status of the property and other related factors to estimate the current value of the collateral. These impaired commercial and commercial real estate loans had a principal amount of \$43.5 million, with a valuation allowance of \$11.0 million at September 30, 2012. Old National recorded \$4.6 million of provision expense associated with these loans for the nine months ended September 30, 2012.

Other real estate owned and other repossessed property is measured at fair value less costs to sell and had a net carrying amount of \$2.6 million. The estimates of fair value are based on the most recently available appraisals with certain adjustments made based on the type of property, age



## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

of appraisal, current status of the property and other related factors to estimate the current value of the collateral. These appraisals are discounted 0% to 45% depending on the type of property and the type of appraisal (market value vs. liquidation value). There were write-downs of other real estate owned of \$1.2 million in the first nine months of 2012.

**Table of Contents**

(dollars in thousands)	Fair Value Measurements at December 31, 2011 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
<b>Collateral Dependent Impaired Loans</b>			Significant Unobservable Inputs (Level 3)
Commercial loans	\$ 23,150		\$ 23,150
Commercial real estate loans	14,894		14,894

As of December 31, 2011, impaired commercial and commercial real estate loans had a principal amount of \$49.4 million, with a valuation allowance of \$11.3 million. Old National recorded \$7.5 million of provision expense associated with these loans in 2011.

The table below provides quantitative information about significant unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy:

(dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value at Sept. 30, 2012	Valuation Techniques	Unobservable Input	Range (Weighted Average)
<b>Collateral Dependent Impaired Loans</b>				
Commercial loans	\$ 18,230	Fair value of collateral	Discount for type of property, age of appraisal and current status	0% - 50% (25%)
Commercial real estate loans	14,196	Fair value of collateral	Discount for type of property, age of appraisal and current status	10% - 40% (25%)
<b>Foreclosed Assets</b>				
Commercial real estate	2,545	Fair value of collateral	Discount for type of property, age of appraisal and current status	10% - 40% (25%)
Residential	83	Fair value of collateral	Discount for type of property, age of appraisal and current status	10% - 45% (25%)

Collateral dependent loans, other real estate owned and other repossessed property are valued based on the most recently available appraisals with certain adjustments made based on the type of property, age of appraisal, current status of the property and other related factors to estimate the current value of the collateral. These appraisals are discounted depending on the type of property and the type of appraisal (market value vs. liquidation value).

**Financial instruments recorded using fair value option**

Under FASB ASC 825-10, the Company may elect to report most financial instruments and certain other items at fair value on an instrument-by-instrument basis with changes in fair value reported in net income. After the initial adoption, the election is made at the acquisition of an eligible financial asset, financial liability or firm commitment or when certain specified reconsideration events occur. The fair value election may not be revoked once an election is made.

The Company has elected the fair value option for residential mortgage loans held for sale. For these loans, interest income is recorded in the consolidated statements of income based on the contractual amount of interest income earned on the financial assets (except any that are on nonaccrual status). None of these loans are 90 days or more past due, nor are any on nonaccrual status. Included in the income statement are \$44 thousand and \$109 thousand of interest income for residential loans held for sale for the three and nine months ended September 30, 2012, respectively. Included in the income statement are \$41 thousand and \$141 thousand of interest income for residential loans held for sale for the three and nine months ended September 30, 2011, respectively.



**Table of Contents**

Residential mortgage loans held for sale

Old National has elected the fair value option for newly originated conforming fixed-rate and adjustable-rate first mortgage loans held for sale. These loans are intended for sale and are hedged with derivative instruments. Old National has elected the fair value option to mitigate accounting mismatches in cases where hedge accounting is complex and to achieve operational simplification. The fair value option was not elected for loans held for investment.

As of September 30, 2012, the difference between the aggregate fair value and the aggregate remaining principal balance for loans for which the fair value option has been elected is as follows. Accrued interest at period end is included in the fair value of the instruments.

(dollars in thousands)	Aggregate Fair Value	Difference	Contractual Principal
Residential loans held for sale	\$ 9,911	\$ 255	\$ 9,656

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets carried at fair value for the three and nine months ended September 30, 2012:

**Changes in Fair Value for the Three Months ended September 30, 2012, for Items**

**Measured at Fair Value Pursuant to Election of the Fair Value Option**

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest (Expense)	Total Changes in Fair Values Included in Current Period Earnings
Residential loans held for sale	\$ 115	\$ 4	\$	\$ 119

**Changes in Fair Value for the Nine Months ended September 30, 2012, for Items**

**Measured at Fair Value Pursuant to Election of the Fair Value Option**

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest (Expense)	Total Changes in Fair Values Included in Current Period Earnings
Residential loans held for sale	\$ 152	\$ 4	\$	\$ 156

As of September 30, 2011, the difference between the aggregate fair value and the aggregate remaining principal balance for loans for which the fair value option has been elected was as follows. Accrued interest at period end is included in the fair value of the instruments.

(dollars in thousands)	Aggregate Fair Value	Difference	Contractual Principal
Residential loans held for sale	\$ 4,710	\$ 158	\$ 4,552

**Table of Contents**

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets carried at fair value for the three and nine months ended September 30, 2011:

**Changes in Fair Value for the Three Months ended September 30, 2011, for Items****Measured at Fair Value Pursuant to Election of the Fair Value Option**

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest (Expense)	Total Changes in Fair Values Included in Current Period Earnings
Residential loans held for sale	\$ (7)	\$	\$	\$ (7)

**Changes in Fair Value for the Nine Months ended September 30, 2011, for Items****Measured at Fair Value Pursuant to Election of the Fair Value Option**

(dollars in thousands)	Other Gains and (Losses)	Interest Income	Interest (Expense)	Total Changes in Fair Values Included in Current Period Earnings
Residential loans held for sale	\$ 179	\$	\$ (1)	\$ 178

**Table of Contents**

The carrying amounts and estimated fair values of financial instruments, not previously presented in this note, at September 30, 2012 and December 31, 2011 are as follows:

(dollars in thousands)	Carrying Value	Fair Value Measurements at September 30, 2012 Using Quoted Prices		
		in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2012</b>				
<b>Financial Assets</b>				
Cash, due from banks, federal funds sold and money market investments	\$ 217,533	\$ 217,533	\$	\$
Investment securities held-to-maturity:				
U.S. Government-sponsored entities and agencies	174,764		188,011	
Mortgage-backed securities Agency	63,222		65,907	
State and political subdivisions	169,539		183,100	
Other securities	2,996		2,996	
Federal Home Loan Bank stock	37,927		37,927	
Loans, net (including covered loans):				
Commercial	1,363,516			1,392,637
Commercial real estate	1,528,167			1,572,405
Residential real estate	1,317,065			1,402,869
Consumer credit	1,034,418			1,061,352
FDIC indemnification asset	126,881			114,433
Accrued interest receivable	46,430	57	19,670	26,703
<b>Financial Liabilities</b>				
Deposits:				
Noninterest-bearing demand deposits	\$ 1,943,525	\$ 1,943,525	\$	\$
NOW, savings and money market deposits	3,916,765	3,916,765		
Time deposits	1,361,087		1,392,219	
Short-term borrowings:				
Federal funds purchased	117,515	117,515		
Repurchase agreements	334,545	334,543		
Other borrowings:				
Junior subordinated debenture	28,000		16,174	
Repurchase agreements	50,000		53,836	
Federal Home Loan Bank advances	206,980			206,980
Capital lease obligation	4,224		5,628	
Accrued interest payable	3,440		3,440	
Standby letters of credit	379			379
<b>Off-Balance Sheet Financial Instruments</b>				
Commitments to extend credit	\$	\$	\$	\$ 2,089

**Table of Contents**

(dollars in thousands)	Carrying Value	Fair Value
<b>December 31, 2011</b>		
<b>Financial Assets</b>		
Cash, due from banks, federal funds sold and money market investments	\$ 222,872	\$ 222,872
Investment securities held-to-maturity:		
U.S. Government-sponsored entities and agencies	177,159	188,593
Mortgage-backed securities Agency	84,075	87,380
State and political subdivisions	216,345	224,717
Other securities	7,011	7,009
Federal Home Loan Bank stock	30,835	30,835
Loans, net (including covered loans):		
Commercial	1,321,445	1,366,316
Commercial real estate	1,366,311	1,421,941
Residential real estate	1,038,280	1,124,222
Consumer credit	983,107	1,014,807
FDIC indemnification asset	167,714	162,226
Accrued interest receivable	44,801	44,801
<b>Financial Liabilities</b>		
Deposits:		
Noninterest-bearing demand deposits	\$ 1,728,546	\$ 1,728,546
NOW, savings and money market deposits	3,435,353	3,435,353
Time deposits	1,447,664	1,481,854
Short-term borrowings:		
Federal funds purchased	103,010	103,010
Repurchase agreements	321,725	321,722
Other short-term borrowings	114	114
Other borrowings:		
Junior subordinated debenture	16,000	12,697
Subordinated notes	13,000	12,999
Repurchase agreements	50,000	54,484
Federal Home Loan Bank advances	208,360	225,711
Capital lease obligation	4,261	5,079
Accrued interest payable	5,239	5,239
Standby letters of credit	431	431
<b>Off-Balance Sheet Financial Instruments</b>		
Commitments to extend credit	\$	\$ 1,720

The following methods and assumptions were used to estimate the fair value of each type of financial instrument.

Cash, due from banks, federal funds sold and resell agreements and money market investments: For these instruments, the carrying amounts approximate fair value (Level 1).

Investment securities: Fair values for investment securities held-to-maturity are based on quoted market prices, if available. For securities where quoted prices are not available, fair values are estimated based on market prices of similar securities (Level 2).

Federal Home Loan Bank Stock: Old National Bank is a member of the Federal Home Loan Bank system. Members 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 is carried at cost and periodically evaluated for impairment based on ultimate recovery of par value. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank (Level 2).

## **Table of Contents**

**Loans:** The fair value of loans is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities (Level 3).

**Covered loans:** Fair values for loans were based on a discounted cash flow methodology that considered factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and a discount rate reflecting current market rates for new originations of comparable loans adjusted for the risk inherent in the cash flow estimates. Loans were grouped together according to similar characteristics and were treated in the aggregate when applying various valuation techniques (Level 3).

**FDIC indemnification asset:** The loss sharing asset was measured separately from the related covered assets as it is not contractually embedded in the assets and is not transferable with the assets should the Bank choose to dispose of the assets. Fair value was originally estimated using projected cash flows related to the loss sharing agreement based on the expected reimbursements for losses and the applicable loss sharing percentage and these projected cash flows are updated with the cash flow estimates on covered assets. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC (Level 3).

**Accrued interest receivable and payable:** The carrying amount approximates fair value and is aligned with the underlying assets or liabilities (Level 1, Level 2 or Level 3).

**Deposits:** The fair value of noninterest-bearing demand deposits and savings, NOW and money market deposits is the amount payable as of the reporting date (Level 1). The fair value of fixed-maturity certificates of deposit is estimated using rates currently offered for deposits with similar remaining maturities (Level 2).

**Short-term borrowings:** Federal funds purchased and other short-term borrowings generally have an original term to maturity of 30 days or less and, therefore, their carrying amount is a reasonable estimate of fair value (Level 1). The fair value of securities sold under agreements to repurchase is determined using end of day market prices (Level 1).

**Other borrowings:** The fair value of medium-term notes, subordinated debt and senior bank notes is determined using market quotes (Level 2). The fair value of FHLB advances is determined using calculated prices for new FHLB advances with similar risk characteristics (Level 3). The fair value of other debt is determined using comparable security market prices or dealer quotes (Level 2).

**Standby letters of credit:** Fair values for standby letters of credit are based on fees currently charged to enter into similar agreements. The fair value for standby letters of credit was recorded in Accrued expenses and other liabilities on the consolidated balance sheet in accordance with FASB ASC 460-10 (FIN 45) (Level 3).

**Off-balance sheet financial instruments:** Fair values for off-balance sheet credit-related financial instruments are based on fees currently charged to enter into similar agreements. For further information regarding the amounts of these financial instruments, see Notes 18 and 19.



**Table of Contents**

**PART I. FINANCIAL INFORMATION**

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

The following discussion is an analysis of our results of operations for the three and nine months ended September 30, 2012 and 2011, and financial condition as of September 30, 2012, compared to September 30, 2011, and December 31, 2011. This discussion and analysis should be read in conjunction with the consolidated financial statements and related notes. This discussion contains forward-looking statements concerning our business that are based on estimates and involves certain risks and uncertainties. Therefore, future results could differ significantly from our current expectations and the related forward-looking statements.

**EXECUTIVE SUMMARY**

During the third quarter of 2012, net income was \$19.7 million, or \$0.20 per share. This compares favorably to the \$16.8 million, or \$0.18 per share reported in the third quarter of 2011. The increase in earnings year over year is primarily the result of our acquisition of Integra Bank, our first FDIC-assisted transaction, which closed on July 29, 2011. During the third quarter of 2012, we continued to benefit from the accretion associated with the purchased credit impaired loans and other purchase accounting adjustments. We expect these benefits to diminish over time.

On September 15, 2012, Old National closed on its acquisition of Indiana Community Bancorp. Old National assumed assets with a fair value of approximately \$906.8 million, including \$496.2 million of loans, and \$784.6 million of deposits. Non-interest expense included \$4.9 million of acquisition and integration costs during the quarter and we expect to incur an additional \$1.0 to \$1.5 million of acquisition and integration costs in the fourth quarter of 2012.

Old National recorded a \$1.3 million core deposit intangible asset associated with the acquired deposits and a \$1.7 million customer relationship intangible associated with the trust business. These intangible assets will be amortized on an accelerated basis over the estimated economic lives of 7 and 12 years, respectively. Goodwill of \$86.7 million was also recorded in conjunction with the transaction.

Regulatory capital remained strong after the transaction with consolidated Tier 1 capital to total average assets ( leverage ratio ) of 8.78% and total capital to risk-adjusted assets of 14.06%. These ratios were 7.79% and 12.59%, respectively, for the Bank.

In addition, the Company continues to focus on initiatives to enhance revenue and drive down expenses. The Company announced the pending sale of deposits from nine former Integra branch locations as well as eight of the banking centers, and the planned consolidation of an additional 19 banking centers into nearby Old National locations. The consolidations are scheduled for the fourth quarter of 2012 and the pending sales will close during the first quarter of 2013. We incurred \$0.8 million of costs associated with these transactions during the third quarter and anticipate additional lease termination and deconversion costs of \$2.0 million to \$2.5 million during the fourth quarter of 2012. Offsetting these efficiency initiatives will be higher costs of continued compliance with BSA/AML programs.

**Table of Contents****RESULTS OF OPERATIONS**

The following table sets forth certain income statement information of Old National for the three and nine months ended September 30, 2012 and 2011:

(dollars in thousands)	Three Months Ended			Nine Months Ended		
	September 30, 2012	2011	% Change	September 30, 2012	2011	% Change
<b>Income Statement Summary:</b>						
Net interest income	\$ 74,150	\$ 72,592	2.1%	\$ 224,396	\$ 196,278	14.3%
Provision for loan losses	400	(82)	NM	2,849	6,437	(55.7)
Noninterest income	40,867	47,326	(13.6)	138,542	133,736	3.6
Noninterest expense	89,019	95,158	(6.5)	266,333	254,841	4.5
<b>Other Data:</b>						
Return on average common equity	7.17%	6.61%		8.57%	6.75%	
Efficiency ratio (1)	75.26	77.56		71.71	74.47	
Tier 1 leverage ratio	8.78	7.88		8.78	7.88	
Net charge-offs to average loans	0.03	0.40		0.17	0.41	

- (1) Efficiency ratio is defined as noninterest expense before amortization of intangibles as a percent of fully taxable net interest income and noninterest income, excluding net gains from securities transactions. This presentation excludes intangible amortization and net securities gains, as is common in other company disclosures, and better aligns with true operating performance.

NM = Not meaningful

**Net Interest Income**

Net interest income is our most significant component of earnings, comprising over 61% of revenues at September 30, 2012. Net interest income and margin are influenced by many factors, primarily the volume and mix of earning assets, funding sources and interest rate fluctuations. Other factors include prepayment risk on mortgage and investment-related assets and the composition and maturity of earning assets and interest-bearing liabilities. Loans typically generate more interest income than investment securities with similar maturities. Funding from client deposits generally cost less than wholesale funding sources. Factors such as general economic activity, Federal Reserve Board monetary policy and price volatility of competing alternative investments, can also exert significant influence on our ability to optimize our mix of assets and funding and our net interest income and margin.

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

**Table of Contents**

(dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net interest income	\$ 74,150	\$ 72,592	\$ 224,396	\$ 196,278
Taxable equivalent adjustment	3,340	2,914	9,643	8,842
<b>Net interest income taxable equivalent</b>	<b>\$ 77,490</b>	<b>\$ 75,506</b>	<b>\$ 234,039</b>	<b>\$ 205,120</b>
Average earning assets	\$ 7,572,282	\$ 7,626,682	\$ 7,458,316	\$ 7,287,482
Net interest margin	3.92%	3.81%	4.01%	3.59%
Net interest margin fully taxable equivalent	4.09%	3.96%	4.18%	3.75%

Net interest income was \$74.2 million and \$224.4 million for the three and nine months ended September 30, 2012, up from the \$72.6 million and \$196.3 million reported for the three and nine months ended September 30, 2011. Taxable equivalent net interest income was \$77.5 million and \$234.0 million for the three and nine months ended September 30, 2012, up from the \$75.5 million and \$205.1 million reported for the three and nine months ended September 30, 2011. The net interest margin on a fully taxable equivalent basis was 4.09% and 4.18% for the three and nine months ended September 30, 2012, compared to 3.96% and 3.75% for the three and nine months ended September 30, 2011. The increase in both net interest income and net interest margin is primarily due to the acquisition of Integra Bank on July 29, 2011 combined with a change in the mix of interest earning assets and interest-bearing liabilities. The accretion associated with the purchased assets from Integra Bank benefited net interest margin by 48 basis points and 52 basis points during the three and nine months ended September 30, 2012. The accretion associated with the purchased assets from Integra Bank benefited net interest margin by 68 basis points and 42 basis points during the three and nine months ended September 30, 2011. We expect this accretion income to decline over time. The yield on interest earning assets decreased 17 basis points while the cost of interest-bearing liabilities decreased 37 basis points in the quarterly year-over-year comparison. In the year-to-date comparison, the yield on average earning assets increased 12 basis points while the cost of interest-bearing liabilities decreased 38 basis points.

Average earning assets were \$7.572 billion for the three months ended September 30, 2012, compared to \$7.627 billion for the three months ended September 30, 2011, a decrease of 0.7%, or \$54.4 million. Average earning assets were \$7.458 billion for the nine months ended September 30, 2012, compared to \$7.287 billion for the nine months ended September 30, 2011, an increase of 2.3% or \$170.8 million. Included in average earning assets for the three and nine months ended September 30, 2012 is approximately \$111.1 million and \$37.0 million, respectively, from the Indiana Community Bancorp acquisition, which was acquired on September 15, 2012. Significantly affecting average earning assets at September 30, 2012 compared to September 30, 2011, was the increase in the size of the loan portfolio combined with a decrease in the size of the investment portfolio and the decrease in interest earning cash balances at the Federal Reserve. A \$420.0 million increase in average loans was partially offset by a \$91.9 million decrease in average investment securities and a \$157.3 million decrease in interest earning cash balances. The increase in average loans is primarily a result of the remaining \$569.8 million of average loans acquired in the Integra Bank acquisition. This increase in acquired loans was partially offset by a decline in commercial and commercial real estate loans that was affected by weak loan demand in our markets. Year over year, the loan portfolio, which generally has an average yield higher than the investment portfolio, has increased as a percent of interest earning assets and was approximately 65 percent of interest earnings assets at September 30, 2012.

Also positively affecting margin was an increase in noninterest-bearing demand deposits combined with decreases in time deposits and other borrowings. During the last six months of 2011, we prepaid \$102.0 million of FHLB advances and \$80.0 million of structured repurchase agreements. In the fourth quarter of 2011, \$150.0 million of subordinated bank notes matured. On June 30, 2012 we redeemed \$13.0 million of subordinated notes and \$3.0 million of trust preferred securities. Year over year, time deposits and other borrowings, which have an average interest rate higher than other types of deposits, have decreased as a percent of total funding. Year over year, noninterest-bearing demand deposits have increased as a percent of total funding.

**Table of Contents****Provision for Loan Losses**

The provision for loan losses was \$0.4 million for the three months ended September 30, 2012, compared to a credit of \$0.1 million for the three months ended September 30, 2011. The provision for loan losses was \$2.8 million for the nine months ended September 30, 2012, compared to \$6.4 million for the nine months ended September 30, 2011. Impacting the provision over the past twelve months are the following factors: (1) the loss factors applied to our performing loan portfolio have decreased over time as charge-offs were substantially lower, (2) the continuing trend in improved credit quality, and (3) the percentage of our legacy loan portfolio consisting of those loans where higher loss factors are applied (commercial and commercial real estate loans) fell while the percentage of our loan portfolio consisting of those loans where lower loss factors are applied (residential loans) increased.

**Noninterest Income**

We generate revenues in the form of noninterest income through client fees and sales commissions from our core banking franchise and other related businesses, such as wealth management, investment consulting, investment products and insurance. Noninterest income for the three months ended September 30, 2012 was \$40.9 million, a decrease of \$6.4 million, or 13.6%, from the \$47.3 million reported for the three months ended September 30, 2011. For the nine months ended September 30, 2012, noninterest income was \$138.5 million, an increase of \$4.8 million, or 3.6%, from the \$133.7 million reported for the nine months ended September 30, 2011. The decrease in the quarterly comparison is primarily the result of adjustments to the FDIC indemnification asset. The increase in the year-to-date comparison is primarily the result of increases in net security gains.

Net securities gains were \$2.7 million and \$9.4 million for the three and nine months ended September 30, 2012, compared to net securities gains of \$2.9 million and \$4.5 million for the three and nine months ended September 30, 2011. Included in the third quarter and first nine months of 2012 are securities gains of \$2.9 million and \$10.5 million, respectively. Partially offsetting these gains were other-than-temporary-impairment charges of \$0.2 million and \$1.1 million, respectively, on six non-agency mortgage-backed securities and one trust preferred security. The securities gains in 2012 were a result of our continuing efforts to reduce the size and duration of the investment portfolio as well as to help with the liquidity needed to retire the subordinated notes and trust preferred securities. Included in the third quarter and first nine months of 2011 are securities gains of \$2.9 million and \$5.0 million, respectively. Partially offsetting these gains for the nine months ended September 30, 2011 were other-than-temporary-impairment charges of \$0.5 million on three non-agency mortgage-backed securities.

Service charges and overdraft fees on deposit accounts were \$12.8 million for the three months ended September 30, 2012, compared to \$14.0 million for the three months ended September 30, 2011. The decrease in revenue is primarily attributable to a decrease in overdraft charges. Service charges and overdraft fees would have declined year-over-year without the Integra Bank acquisition and the \$6.1 million it contributed during the nine months ended September 30, 2012.

Debit card and ATM fees were \$5.7 million and \$17.9 million for the three and nine months ended September 30, 2012, compared to \$6.8 million and \$18.7 million for the three and nine months ended September 30, 2011. A decrease in interchange income is the primary reason for the decrease.

Investment product fees were \$9.5 million for the nine months ended September 30, 2012, compared to \$8.5 million for the nine months ended September 30, 2011. The increase is primarily as a result of increases in mutual fund fees and other investment advisory fees.

Revenue from company-owned life insurance was \$1.7 million and \$4.7 million for the three and nine months ended September 30, 2012, compared to \$1.4 million and \$3.9 million for the three and nine months ended September 30, 2011. We anticipate this revenue will continue to slowly improve.

Other income increased \$3.3 million for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011. The increase is primarily a result of increases in customer derivative fee revenue, rental income from an operating lease, gains on sales of foreclosed properties and other miscellaneous income.

---

**Table of Contents****Noninterest Income Related to Covered Assets**

Income and expense associated with the FDIC loss sharing agreements is reflected in the change in the FDIC indemnification asset. This balance includes discount accretion, gains on the write-up of the FDIC indemnification asset, and expense from the reduction of the FDIC indemnification asset upon the removal of loans, OREO and unfunded loan commitments. Loans are removed when they have been fully paid off, fully charged off, sold or transferred to OREO. The change in the FDIC indemnification asset also includes income due to the FDIC, as well as the income statement effects of other loss share transactions.

For the third quarter of 2012, adjustments to the FDIC indemnification asset resulted in noninterest income/ (expense) of (\$4.9) million. This compares to noninterest income of \$0.5 million during the third quarter of 2011. Adjustments to the FDIC indemnification asset resulted in noninterest income/(expense) of (\$4.1) million during the first nine months of 2012 compared to \$0.5 million during the nine months ended September 30, 2011.

The decrease in income year over year is primarily the result of improvement in our loan loss expectations, which was partially offset by impairment of other real estate.

**Noninterest Expense**

Noninterest expense for the three months ended September 30, 2012, totaled \$89.0 million, a decrease of \$6.1 million, or 6.5%, from the \$95.2 million recorded for the three months ended September 30, 2011. Salaries, benefits and professional fees declined after the Integra systems conversion in December 2011. For the nine months ended September 30, 2012, noninterest expense totaled \$266.3 million, an increase of \$11.5 million, or 4.5%, from the \$254.8 million recorded for the nine months ended September 30, 2011. An increase in other real estate expense is the primary reason for the increase in noninterest expense in the year-to-date comparison. Included in the nine months ended September 30, 2012 is \$10.6 million of impairment associated with certain OREO properties acquired in our FDIC assisted transaction. Also included in the three and nine months ended September 30, 2012 is approximately \$4.9 million and \$6.4 million, respectively, related to Integra and Indiana Community Bancorp acquisition and integration costs.

Salaries and benefits is the largest component of noninterest expense. For the three months ended September 30, 2012, salaries and benefits were \$49.9 million compared to \$52.3 million for the three months ended September 30, 2011. For the nine months ended September 30, 2012, salaries and benefits were \$142.7 million compared to \$139.9 million for the nine months ended September 30, 2011. Included in the third quarter of 2012 is an increase of \$3.4 million for salaries and benefits expense associated with former IBT associates, which includes severance and retention accruals. Offsetting the increase from IBT is a reduction of approximately \$5.2 million in salaries and benefits expense associated with former Integra Bank associates. Also included in the third quarter of 2012 is a \$0.3 million decrease in hospitalization and long-term disability insurance expense. Included in the first nine months of 2012 is \$3.4 million of salaries and benefits expense associated with former IBT associates. Partially offsetting the increase from IBT is a reduction of approximately \$2.9 million in salaries and benefits expense associated with former Integra Bank associates. Also included in the first nine months of 2012 is a \$6.4 million increase in expense related to the reinstatement of our performance-based incentive compensation plan. Partially offsetting this increase is a \$1.3 million decrease in hospitalization and long-term disability expense, a \$1.8 million decrease in severance expense and a \$0.6 million decrease in restricted stock expense and our cost containment efforts.

Occupancy expense was \$39.2 million for the nine months ended September 30, 2012, compared to \$37.8 million for the nine months ended September 30, 2011. The increase was primarily attributable to increases in real estate taxes and building depreciation expense.

Professional fees decreased \$2.1 million and \$1.3 million for the three and nine months ended September 30, 2012, compared to the three and nine months ended September 30, 2011. The decreases are primarily attributable to legal and other professional fees associated with the acquisition of Integra Bank in 2011. Continued compliance with the June 4, 2012, consent order issued by our primary regulator is expected to result in increased professional fees during the fourth quarter of 2012 and first quarter of 2013 as the Company continues to progress on this project. The consent order requires the Bank to, among other things: continue to review, update, and implement a written institution-wide, ongoing BSA/AML risk assessment that accurately identifies BSA/AML risks; ensure that Bank management reviews, updates, and implements its risk-based processes to obtain and analyze appropriate customer due diligence information to monitor for and investigate suspicious activity; ensure adherence to a written program for appropriate identification, analyzing and monitoring of transactions with greater than normal risk; maintain an effective BSA independent testing function; and ensure and maintain sufficient personnel with requisite expertise and skills who receive adequate on-going training.



---

**Table of Contents**

Loan expense increased \$0.6 million and \$1.5 million for the three and nine months ended September 30, 2012, compared to the three and nine months ended September 30, 2011. The increase is primarily attributable to loan expense associated with the acquisition of Integra Bank.

For the three and nine months ended September 30, 2012, FDIC assessment expense was \$1.3 million and \$4.1 million compared to \$1.7 million and \$5.6 million for the three and nine months ended September 30, 2011. The decrease is primarily due to a lower assessment rate.

Other real estate owned expense was \$0.4 million and \$11.8 million for the three and nine months ended September 30, 2012, compared to \$0.6 million and \$1.7 million for the three and nine months ended September 30, 2011. The increase is primarily due to expense related to decreased valuations of other real estate owned acquired in our FDIC assisted transaction. Eighty percent of these impairment losses are reimbursable by the FDIC upon ultimate sale of the property.

Other expense for the three months ended September 30, 2012, totaled \$3.3 million, a decrease of \$1.8 million compared to the three months ended September 30, 2011. Other expense for the nine months ended September 30, 2012, totaled \$8.5 million, a decrease of \$1.4 million compared to the nine months ended September 30, 2011. The decreases are primarily attributable to an accrual for a litigation settlement of \$2.0 million in September 2011.

**Noninterest Expense Related to Covered Assets**

Noninterest expense related to covered assets are included in OREO expense, legal and professional expense and other covered asset-related expenses, and may be subject to FDIC reimbursement. Expenses must meet certain FDIC criteria in order for the expense amounts to be reimbursed. Certain amounts reflected in these balances may not be reimbursed by the FDIC if they do not meet the criteria.

\$671 thousand, or twenty percent of the expense associated with holding and maintaining covered assets assumed in the Integra acquisition, are not reimbursable by the FDIC and were recorded as noninterest expense during the first nine months of 2012. The remaining eighty percent was recorded as a receivable from the FDIC. Additional non-reimbursable expenses of \$359 thousand associated with holding and maintaining covered assets assumed in the Integra acquisition were also recorded in noninterest expense during the first nine months of 2012. Expense of \$164 thousand was recorded during the third quarter of 2011 associated with holding and maintaining OREO properties assumed in the Integra acquisition.

**Provision for Income Taxes**

We record a provision for income taxes currently payable and for income taxes payable or benefits to be received in the future, which arise due to timing differences in the recognition of certain items for financial statement and income tax purposes. The major difference between the effective tax rate applied to our financial statement income and the federal statutory tax rate is caused by interest on tax-exempt securities and loans. The provision for income taxes, as a percentage of pre-tax income, was 22.9% for the three months ended September 30, 2012, compared to 32.4% for the three months ended September 30, 2011. The decrease in the quarterly comparison is primarily a result of adjustments to our state income tax apportionment rates. The provision for income taxes, as a percentage of pre-tax income, was 26.8% for the nine months ended September 30, 2012, compared to 26.9% for the nine months ended September 30, 2011. In accordance with ASC 740-270, Accounting for Interim Reporting, the provision for income taxes was recorded at September 30, 2012 based on the current estimate of the effective annual rate. The tax rate was effectively the same for the nine months of 2012 and 2011. See Note 16 to the consolidated financial statements for additional information.

**Table of Contents****FINANCIAL CONDITION****Overview**

At September 30, 2012, our assets were \$9.383 billion, a 5.0% increase compared to September 30, 2011 assets of \$8.933 billion, and an increase of 9.0% compared to December 31, 2011 assets of \$8.610 billion. The increase from September 30, 2011 is primarily a result of the acquisition of Indiana Community Bancorp, which occurred in the third quarter of 2012. Year over year, we have also reduced our reliance on higher cost deposits and other borrowings. Time deposits and other borrowings, which have an average interest rate higher than other types of deposits, have decreased as a percent of total funding. Year over year, noninterest-bearing demand deposits have increased as a percent of total funding.

**Earning Assets**

Our earning assets are comprised of investment securities, portfolio loans, loans held for sale, money market investments, interest earning accounts with the Federal Reserve and trading securities. Earning assets were \$8.054 billion at September 30, 2012, an increase of 4.4% from September 30, 2011.

*Investment Securities*

We classify the majority of our investment securities as available-for-sale to give management the flexibility to sell the securities prior to maturity if needed, based on fluctuating interest rates or changes in our funding requirements. However, we do have \$63.2 million of 15- and 20-year fixed-rate mortgage pass-through securities, \$174.8 million of U.S. government-sponsored entity and agency securities and \$169.5 million of state and political subdivision securities in our held-to-maturity investment portfolio at September 30, 2012.

Trading securities, which consist of mutual funds held in a trust associated with deferred compensation plans for former Monroe Bancorp directors and executives, are recorded at fair value and totaled \$3.0 million at September 30, 2012 compared to \$2.8 million at September 30, 2011.

At September 30, 2012, the total investment securities portfolio was \$2.764 billion compared to \$2.784 billion at September 30, 2011, a decrease of \$19.8 million or 0.7%. Investment securities increased \$174.8 million compared to December 31, 2011, an increase of 6.7%. Investment securities represented 34.3% of earning assets at September 30, 2012, compared to 36.1% at September 30, 2011, and 35.0% at December 31, 2011. Included in the September 30, 2012 investment securities portfolio is approximately \$122.7 million related to our acquisition of Indiana Community Bancorp. The decrease in investment securities since September 30, 2011 is a result of U.S. Treasury securities and mortgage-backed securities that were held in the available-for-sale portfolio and matured or were sold and mortgage-backed and political subdivision securities that were held in the held-to-maturity portfolio and matured or were called by the issuers. This activity more than offset the increase in securities acquired in the Indiana Community Bancorp transaction. The increase in investment securities since December 31, 2011 is a result of purchases of U.S. government-sponsored entity and agency securities and state and political subdivision securities which exceeded the amount of U.S. Treasury securities and mortgage-backed securities that were sold, matured or called by the issuers combined with the acquisition of Indiana Community Bancorp. Stronger commercial loan demand in the future and management's efforts to deleverage the balance sheet could result in a reduction in the securities portfolio. As of September 30, 2012, management does not intend to sell any securities with an unrealized loss position and does not believe the Company will be required to sell such securities.

The investment securities available-for-sale portfolio had net unrealized gains of \$69.9 million at September 30, 2012, an increase of \$22.1 million compared to net unrealized gains of \$47.8 million at September 30, 2011, and an increase of \$29.4 million compared to net unrealized gains of \$40.5 million at December 31, 2011. A \$1.1 million charge was recorded during the first nine months of 2012 related to other-than-temporary-impairment on six non-agency mortgage-backed securities and one trust preferred security. A \$0.5 million charge was recorded during the first nine months of 2011 related to other-than-temporary-impairment on three non-agency mortgage-backed securities. See the consolidated statements of comprehensive income for the impact of other-than-temporary-impairment in other comprehensive income and Note 6 to the consolidated financial statements for details on management's evaluation of securities for other-than-temporary-impairment.



**Table of Contents**

The investment portfolio had an average duration of 3.54% at September 30, 2012, compared to 3.51% at September 30, 2011, and 3.63% at December 31, 2011. Effective duration measures the percentage change in value of the portfolio in response to a 100 basis point change in interest rates. Generally, there is more uncertainty in interest rates over a longer average maturity, resulting in a higher duration percentage. The annualized average yields on investment securities, on a taxable equivalent basis, were 3.22% for the three months ended September 30, 2012, compared to 3.30% for the three months ended September 30, 2011, and 3.28% for the three months ended December 31, 2011. Average yields on investment securities, on a taxable equivalent basis, were 3.28%, 3.52% and 3.46% for the nine months ended September 30, 2012 and 2011, and for the year ended December 31, 2011.

*Residential Loans Held for Sale*

Residential loans held for sale were \$9.9 million at September 30, 2012, compared to \$4.7 million at September 30, 2011, and \$4.5 million at December 31, 2011. At September 30, 2012, loans held for sale is made up entirely of mortgage loans held for immediate sale in the secondary market with servicing released. These loans are sold at or prior to origination at a contracted price to an outside investor on a best efforts basis and remain on the Company's balance sheet for a short period of time (typically 30 to 60 days). These loans are sold without recourse. Old National has received minimal requests to repurchase loans due to the standard representations and warranties and has experienced no material losses. Mortgage originations are subject to volatility due to interest rates and home sales. Residential loans held for sale have declined since the end of 2009, as we have retained certain of our loan originations to partially offset the slow loan demand from our traditional commercial customers.

We have elected the fair value option under FASB ASC 825-10 (SFAS No. 159) prospectively for residential loans held for sale. The aggregate fair value exceeded the unpaid principal balances by \$0.3 million and \$0.2 million as of September 30, 2012 and September 30, 2011, respectively. At December 31, 2011, the aggregate fair value exceeded the unpaid principal balances by \$0.1 million.

*Commercial and Commercial Real Estate Loans*

Commercial and commercial real estate loans, including covered loans, are the largest classification within earning assets, representing 35.9% of earning assets at September 30, 2012, a decrease from 37.6% at September 30, 2011, and a decrease from 37.0% at December 31, 2011. At September 30, 2012, commercial and commercial real estate loans, including covered loans, were \$2.892 billion, a decrease of \$5.0 million since September 30, 2011, and an increase of \$157.0 million since December 31, 2011. Included in the total for September 30, 2012 is approximately \$319.5 million related to our acquisition of Indiana Community Bancorp. Although weak loan demand in our markets affected organic loan growth in prior periods, we have experienced loan growth in commercial and commercial real estate loans during the second and third quarters of 2012.

*Consumer Loans*

At September 30, 2012, consumer loans, including automobile loans, personal and home equity loans and lines of credit, decreased \$3.6 million or 0.3% compared to September 30, 2011, and increased \$44.4 million or 4.5% since December 31, 2011. Included in the total for September 30, 2012 is approximately \$78.5 million related to our acquisition of Indiana Community Bancorp.

*Residential Real Estate Loans*

At September 30, 2012, residential real estate loans, including covered loans, held in our loan portfolio were \$1.317 billion, an increase of \$274.6 million, or 26.3%, from December 31, 2011 and an increase of \$400.4 million, or 43.7%, from September 30, 2011. In addition to organic loan production, September 30, 2012 totals also include approximately \$79.1 million acquired from Indiana Community Bancorp. The majority of the growth in residential real estate loans began in the fourth quarter of 2010, primarily as a result of a new mortgage product that was introduced. We have also retained more of our loan originations to partially offset the slow loan demand from our traditional commercial customers.

**Table of Contents****Covered Assets**

On July 29, 2011, Old National acquired the banking operations of Integra Bank N.A. ( Integra ) in an FDIC assisted transaction. The Company entered into separate loss sharing agreements with the FDIC providing for specified credit loss protection for substantially all acquired single family residential loans, commercial loans, and other real estate owned ( OREO ). Loans comprise the majority of the assets acquired and are subject to loss share agreements with the FDIC whereby Old National is indemnified against 80% of losses up to \$275.0 million, losses in excess of \$275.0 million up to \$467.2 million at 0% reimbursement, and 80% of losses in excess of \$467.2 million with respect to covered assets. As of September 30, 2012, we do not expect losses to exceed \$275.0 million.

A summary of covered assets is presented below:

(dollars in thousands)	September 30, 2012	December 31, 2011
Loans, net of discount & allowance	\$ 444,455	\$ 625,417
Other real estate owned	28,780	30,443
<b>Total covered assets</b>	<b>\$ 473,235</b>	<b>\$ 655,860</b>

**FDIC Indemnification Asset**

Because the FDIC will reimburse Old National for losses incurred on certain acquired loans, an indemnification asset is recorded at fair value at the acquisition date. The indemnification asset is recognized at the same time as the indemnified loans, and measured on the same basis, subject to collectibility or contractual limitations. The indemnification asset, on the acquisition date, reflects the reimbursements expected to be received from the FDIC, using an appropriate discount rate, which reflects counterparty credit risk and other uncertainties. Reimbursement claims are submitted to the FDIC and the receivable is reduced when the FDIC pays the claim. At September 30, 2012, the FDIC indemnification asset was \$126.9 million and was comprised of a \$111.8 million FDIC indemnification asset and a \$15.1 million FDIC loss share receivable. The loss share receivable represents the current reimbursable amounts from the FDIC that have not yet been received. The indemnification asset represents the cash flows the Company expects to collect from the FDIC under the loss sharing agreements and the amount related to the estimated improvements in cash flow expectations that are being amortized over the same period for which those improved cash flows are being accreted into income. At September 30, 2012, \$95.0 million of the FDIC indemnification asset related to expected indemnification payments and \$16.8 million is expected to be amortized against future accreted interest income.

A summary of activity for the indemnification asset and loss share receivable is presented below:

(dollars in thousands)	
Balance at January 1, 2012	\$ 167,714
Adjustments not reflected in income:	
Established through acquisitions	
Cash received from FDIC	(36,338)
Other	(377)
Adjustments reflected in income:	
(Amortization) accretion	(10,614)
Impairment	624
Write-downs/sale of other real estate	8,517
Recovery amounts due to FDIC	(1,915)
Other	(730)
<b>Balance at September 30, 2012</b>	<b>\$ 126,881</b>

---

**Table of Contents****Goodwill and Other Intangible Assets**

Goodwill and other intangible assets at September 30, 2012, totaled \$371.2 million, an increase of \$68.9 million compared to \$302.3 million at September 30, 2011, and an increase of \$84.4 million compared to \$286.8 million at December 31, 2011. During the third quarter of 2012, we recorded \$89.7 million of goodwill and other intangible assets associated with the acquisition of Indiana Community Bancorp, of which \$87.0 million is included in the Community Banking column and \$2.7 million is included in the Other column for segment reporting. The increase from December 31, 2011 is primarily attributable to the acquisition of Indiana Community Bancorp, partially offset by amortization expense associated with other intangible assets.

**Assets Held for Sale**

Assets held for sale were \$15.5 million at September 30, 2012 compared to \$16.9 million at December 31, 2011. Included in assets held for sale are thirteen financial centers associated with the Integra acquisition, four facilities associated with the Monroe Bancorp acquisition and two facilities associated with the Indiana Community Bancorp acquisition.

**Other Assets**

Other assets have increased \$37.0 million, or 17.6%, since September 30, 2011 and increased \$38.4 million, or 18.3%, since December 31, 2011. The increases are primarily a result of increases in deferred tax assets.

**Funding**

Total funding, comprised of deposits and wholesale borrowings, was \$7.962 billion at September 30, 2012, an increase of 4.0% from \$7.652 billion at September 30, 2011, and an increase of 8.7% from \$7.327 billion at December 31, 2011. Included in total funding were deposits of \$7.221 billion at September 30, 2012, an increase of \$354.1 million, or 5.2%, compared to September 30, 2011, and an increase of \$609.8 million, or 9.2%, compared to December 31, 2011. Included in total deposits at September 30, 2012 are \$740.2 million from the acquisition of Indiana Community Bancorp. Noninterest-bearing deposits increased 12.4%, or \$215.0 million, compared to September 30, 2011. Savings deposits increased 19.4%, or \$314.9 million. NOW deposits increased 11.7% or \$177.7 million compared to September 30, 2011. Money market deposits decreased 7.8%, or \$23.8 million, while time deposits decreased 19.5% or \$329.6 million compared to September 30, 2011. We continue to experience an increase in noninterest-bearing demand deposits.

We use wholesale funding to augment deposit funding and to help maintain our desired interest rate risk position. At September 30, 2012, wholesale borrowings, including short-term borrowings and other borrowings, decreased \$44.3 million, or 5.6%, from September 30, 2011 and increased \$24.9 million, or 3.5%, from December 31, 2011, respectively. Included in wholesale funding at September 30, 2012 is \$24.5 million from the acquisition of Indiana Community Bancorp. Wholesale funding as a percentage of total funding was 9.3% at September 30, 2012, compared to 10.3% at September 30, 2011, and 9.8% at December 31, 2011. Short-term borrowings have increased \$111.1 million since September 30, 2011 while long-term borrowings have decreased \$155.4 million since September 30, 2011. During the last six months of 2011, we prepaid \$102.0 million of FHLB advances and \$80.0 million of structured repurchase agreements. In the fourth quarter of 2011, \$150.0 million of subordinated bank notes matured. On June 30, 2012 we redeemed \$13.0 million of subordinated notes and \$3.0 million of trust preferred securities.

**Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities decreased \$14.6 million, or 5.9%, from December 31, 2011, primarily as a result of a decrease in the settlement liability with the FDIC associated with our FDIC-assisted acquisition of Integra Bank.

**Table of Contents****Capital**

Shareholders' equity totaled \$1.187 billion at September 30, 2012, compared to \$1.028 billion at September 30, 2011, and \$1.034 billion at December 31, 2011. The September 30, 2012 balance includes approximately \$88.5 million from the approximately 6.6 million shares of common stock that were issued in the acquisition of Indiana Community Bancorp.

We paid cash dividends of \$0.09 and \$0.27 per share for the three and nine months ended September 30, 2012, which reduced equity by \$25.6 million. We paid cash dividends of \$0.07 and \$0.21 per share for the three and nine months ended September 30, 2011, which reduced equity by \$19.9 million. We repurchased shares of our stock, reducing shareholders' equity by \$0.8 million during the nine months ended September 30, 2012, and \$0.3 million during the nine months ended September 30, 2011. The repurchases related primarily to our employee stock based compensation plans. The change in unrealized losses on investment securities increased equity by \$17.6 million during the nine months ended September 30, 2012, and increased equity by \$24.4 million during the nine months ended September 30, 2011. Shares issued for reinvested dividends, stock options, restricted stock and stock compensation plans increased shareholders' equity by \$3.2 million during the nine months ended September 30, 2012, compared to \$3.0 million during the nine months ended September 30, 2011.

**Capital Adequacy**

Old National and the banking industry are subject to various regulatory capital requirements administered by the federal banking agencies. At September 30, 2012, Old National and its bank subsidiary exceeded the regulatory minimums and Old National Bank met the regulatory definition of well-capitalized based on the most recent regulatory definition. To be categorized as well-capitalized, the bank subsidiary must maintain at least a total risk-based capital ratio of 10.0%, a Tier 1 risk-based capital ratio of 6.0% and a Tier 1 leverage ratio of 5.0%. Goodwill of \$86.7 million, core deposit intangibles of \$1.3 million and customer relationship intangibles of \$1.7 million were recorded in conjunction with the Indiana Community Bancorp acquisition. Such goodwill and intangibles are excluded from regulatory capital as calculated under regulatory accounting practices.

As of September 30, 2012, Old National's consolidated capital position remains strong as evidenced by the following comparisons of key industry ratios.

	Regulatory Guidelines Minimum	September 30, 2012	September 30, 2011	December 31, 2011
<b>Risk-based capital:</b>				
Tier 1 capital to total avg assets (leverage ratio)	4.00%	8.78%	7.88%	8.29%
Tier 1 capital to risk-adjusted total assets	4.00	12.93	12.17	13.51
Total capital to risk-adjusted total assets	8.00	14.06	13.67	14.99
Shareholders' equity to assets	N/A	12.65	11.50	12.00

As of September 30, 2012, Old National Bank, Old National's bank subsidiary, maintained a strong capital position as evidenced by the following comparisons of key industry ratios.

	Regulatory Guidelines Minimum	Well Capitalized Guidelines	September 30, 2012	September 30, 2011	December 31, 2011
<b>Risk-based capital:</b>					
Tier 1 capital to total avg assets (leverage ratio)	4.00%	5.00%	7.79%	7.08%	7.42%
Tier 1 capital to risk-adjusted total assets	4.00	6.00	11.45	11.00	12.16
Total capital to risk-adjusted total assets	8.00	10.00	12.59	12.27	13.40

---

## **Table of Contents**

### **RISK MANAGEMENT**

#### **Overview**

Management, with the oversight of the Board of Directors through its Risk and Credit Policy Committee and its Funds Management Committee, has in place company-wide structures, processes, and controls for managing and mitigating risk. The following discussion addresses the three major risks that we face: credit, market, and liquidity.

#### **Credit Risk**

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

#### **Investment Activities**

Within our securities portfolio, the non-agency collateralized mortgage obligations represent the greatest exposure to the current instability in the residential real estate and credit markets. At September 30, 2012, we had seven non-agency collateralized mortgage obligations with a market value of \$32.7 million or approximately 1.4% of the available-for-sale securities portfolio. Five of these securities were rated below investment grade. The net unrealized gain on these securities at September 30, 2012, was approximately \$1.0 million.

We expect conditions in the overall residential real estate market to remain uncertain for the foreseeable future. Deterioration in the performance of the underlying loan collateral could result in deterioration in the performance of our asset-backed securities. During the third quarter of 2012 we sold three non-agency mortgage-backed securities with an amortized cost of approximately \$39.5 million that were below investment grade. During the second quarter of 2012 we sold one non-agency mortgage-backed security with an amortized cost of approximately \$1.4 million that was below investment grade. Five non-agency mortgage-backed securities were rated below investment grade as of September 30, 2012. During the first nine months of 2012, we experienced \$0.9 million of other-than-temporary-impairment losses on six of these securities, which were recorded as a credit loss in earnings. During the first nine months of 2011, we experienced \$1.9 million of other-than-temporary-impairment losses on three of these securities, of which \$0.5 million was recorded as a credit loss in earnings and \$1.4 million was included in other comprehensive income.

We also carry a higher exposure to loss in our pooled trust preferred securities, which are collateralized debt obligations, due to illiquidity in that market and the performance of the underlying collateral. At September 30, 2012, we had pooled trust preferred securities with a fair value of approximately \$9.1 million, or 0.4% of the available-for-sale securities portfolio. During the first nine months of 2012, we experienced \$0.2 million of other-than-temporary-impairment losses on one of these securities, which was recorded as a credit loss in earnings. These securities remained classified as available-for-sale and at September 30, 2012, the unrealized loss on our pooled trust preferred securities was approximately \$16.2 million. During the first nine months of 2011, we experienced no other-than-temporary-impairment on these securities.

The remaining mortgage-backed securities are backed by U.S. government-sponsored or federal agencies. Municipal bonds, corporate bonds and other debt securities are evaluated by reviewing the credit-worthiness of the issuer and general market conditions. We do not have the intent to sell these securities and it is likely that we will not be required to sell these securities before their anticipated recovery.

Included in the held-to-maturity category at September 30, 2012 are approximately \$63.2 million of agency mortgage-backed securities and \$169.5 million of municipal securities at amortized cost.

#### **Counterparty Exposure**

Counterparty exposure is the risk that the other party in a financial transaction will not fulfill its obligation in a financial transaction. We define counterparty exposure as nonperformance risk in transactions involving federal funds sold and purchased, repurchase agreements, correspondent bank relationships, and derivative contracts with companies in the financial services industry. Old National's net counterparty exposure was an asset of \$530.7 million at September 30, 2012.

---

## Table of Contents

### Lending Activities

#### Commercial

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

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

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

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

#### Consumer

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

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

## Table of Contents

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

### Asset Quality

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

We lend primarily to small- and medium-sized commercial and commercial real estate clients in various industries including manufacturing, agribusiness, transportation, mining, wholesaling and retailing. At September 30, 2012, we had no concentration of loans in any single industry exceeding 10% of our portfolio and had no exposure to foreign borrowers or sovereign debt. Our policy is to concentrate our lending activity in the geographic market areas we serve, primarily Indiana, Illinois and Kentucky. We continue to be affected by weakness in the economy of our principal markets. Management expects that trends in under-performing, criticized and classified loans will be influenced by the degree to which the economy strengthens or weakens.

During the third quarter of 2011, Old National acquired the banking operations of Integra Bank in an FDIC assisted transaction. As of September 30, 2012, acquired loans totaled \$494.6 million and there was \$28.8 million of other real estate owned. The Company entered into separate loss sharing agreements with the FDIC providing for specified credit loss protection for substantially all acquired single family residential loans, commercial loans, and other real estate owned. In accordance with accounting for business combinations, there was no allowance brought forward on any of the acquired loans, as the credit losses evident in the loans were included in the determination of the fair value of the loans at the acquisition date. At September 30, 2012, approximately \$444.5 million of loans, net of allowance, and \$28.8 million of other real estate owned are covered by the loss sharing agreements. Under the terms of the loss sharing agreements, the FDIC will reimburse Old National for 80% of losses up to \$275.0 million. These covered assets are included in our summary of under-performing, criticized and classified assets found below.

On September 15, 2012, Old National closed on its acquisition of Indiana Community Bancorp ( IBT ). As of September 30, 2012, acquired loans totaled \$479.2 million and there was \$5.6 million of other real estate owned. In accordance with accounting for business combinations, there was no allowance brought forward on any of the acquired loans, as the credit losses evident in the loans were included in the determination of the fair value of the loans at the acquisition date. Old National reviewed the acquired loans and determined that as of September 30, 2012, \$24.5 million met the definition of criticized, \$29.3 million were considered classified, and \$67.1 million were doubtful. Our current preference would be to work these loans and avoid foreclosure actions unless additional credit deterioration becomes apparent. These assets are included in our summary of under-performing, criticized and classified assets found below.

**Table of Contents**

Summary of under-performing, criticized and classified assets:

(dollars in thousands)	September 30, 2012	September 30, 2011	December 31, 2011
<b>Nonaccrual loans</b>			
Commercial	\$ 41,187	\$ 37,739	\$ 34,104
Commercial real estate	105,555	72,717	66,187
Residential real estate	10,233	9,234	10,247
Consumer	4,619	5,102	4,790
Covered loans (5) (6)	123,741	199,028	182,880
<b>Total nonaccrual loans</b>	<b>285,335</b>	323,820	298,208
Renegotiated loans not on nonaccrual	10,389		1,325
<b>Past due loans (90 days or more and still accruing)</b>			
Commercial	180	408	358
Commercial real estate	50	490	279
Residential real estate			
Consumer	351	260	473
Covered loans (5)	64	692	2,338
<b>Total past due loans</b>	<b>645</b>	1,850	3,448
Other real estate owned	14,282	9,390	7,119
Other real estate owned, covered (5)	28,780	31,908	30,443
<b>Total under-performing assets</b>	<b>\$ 339,431</b>	\$ 366,968	\$ 340,543
<b>Classified loans (includes nonaccrual, renegotiated, past due 90 days and other problem loans)</b>	<b>\$ 260,047</b>	\$ 226,352	\$ 204,120
Classified loans, covered (5)	148,700	216,220	200,221
Other classified assets (3)	56,425	113,161	106,880
Criticized loans	135,253	98,516	80,148
Criticized loans, covered (5)	14,300	26,913	23,034
<b>Total criticized and classified assets</b>	<b>\$ 614,725</b>	\$ 681,162	\$ 614,403
<b>Asset Quality Ratios including covered assets:</b>			
Non-performing loans/total loans (1) (2)	5.64%	6.67%	6.28%
Under-performing assets/total loans and other real estate owned (1)	6.42	7.50	7.09
Under-performing assets/total assets	3.62	4.11	3.96
Allowance for loan losses/under-performing assets (4)	16.13	17.85	17.05
<b>Asset Quality Ratios excluding covered assets:</b>			
Non-performing loans/total loans (1) (2)	3.59	3.01	2.82
Under-performing assets/total loans and other real estate owned (1)	3.89	3.26	3.01
Under-performing assets/total assets	1.99	1.52	1.45
Allowance for loan losses/under-performing assets (4)	26.99	48.19	45.74

(1) Loans exclude residential loans held for sale and leases held for sale.

(2) Non-performing loans include nonaccrual and renegotiated loans.

(3) Includes 8 pooled trust preferred securities, 5 non-agency mortgage-backed securities and 4 corporate securities at September 30, 2012.

(4) Because the acquired loans from Monroe, Integra and Indiana Community were recorded at fair value in accordance with ASC 805 at the date of acquisition, the credit risk is incorporated in the fair value recorded. No allowance for loan losses is recorded on the acquisition date.



## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

- (5) The Company entered into separate loss sharing agreements with the FDIC providing for specified credit loss protection for substantially all acquired single family residential loans, commercial loans and other real estate owned. At June 30, 2012, we expect eighty percent of any losses incurred on these covered assets to be reimbursed to Old National by the FDIC.
- (6) These covered loans are categorized as nonaccrual because the collection of principal or interest is doubtful. Covered loans are accounted for under FASB ASC 310-30 and accordingly treated as performing assets.

---

**Table of Contents**

Under-performing assets totaled \$339.4 million at September 30, 2012, a decrease of \$27.6 million compared to \$367.0 million at September 30, 2011, and a decrease of \$1.1 million compared to \$340.5 million at December 31, 2011. As a percent of total loans and other real estate owned, under-performing assets, at September 30, 2012, were 6.42%, a decrease from the September 30, 2011 ratio of 7.50% and a decrease from the December 31, 2011 ratio of 7.09%. Nonaccrual loans were \$285.3 million at September 30, 2012, compared to \$323.8 million at September 30, 2011, and \$298.2 million at December 31, 2011. Because the acquired loans from Monroe Bancorp, Integra Bank and Indiana Community Bancorp were recorded at fair value in accordance with ASC 805 at the date of acquisition, the credit risk is incorporated in the fair value recorded. No allowance for loan losses is recorded on the acquisition date. At September 30, 2012, under-performing assets related to covered assets acquired in the Integra Bank acquisition were approximately \$152.6 million, which included approximately \$123.7 million of nonaccrual loans, \$0.1 million of past due loans and \$28.8 million of other real estate owned. The nonaccrual covered loans are categorized in this manner because the collection of principal or interest is doubtful. However, they are accounted for under FASB ASC 310-30 and accordingly treated as performing assets. At September 30, 2012, under-performing assets related to Indiana Community Bancorp were approximately \$72.7 million, which included approximately \$67.1 million of nonaccrual loans and \$5.6 million of other real estate owned.

Total classified and criticized assets were \$614.7 million at September 30, 2012, a decrease of \$66.4 million from September 30, 2011, and an increase of \$0.3 million from December 31, 2011. Included in criticized and classified assets at September 30, 2011, is \$120.8 million related to the acquisition of Indiana Community Bancorp. Other classified assets include \$56.4 million, \$113.2 million and \$106.9 million of investment securities that fell below investment grade rating at September 30, 2012, September 30, 2011 and December 31, 2011, respectively.

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

Any loans that are modified are reviewed by Old National to identify if a troubled debt restructuring ( TDR ) has occurred, which is when for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status. During the nine months ended September 30, 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate of new debt with similar risk, or a permanent reduction of the recorded investment of the loan.

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

If the Company is unable to resolve a nonperforming loan issue the credit will be charged off when it is apparent there will be a loss. For large commercial type loans, each relationship is individually analyzed for evidence of apparent loss based on quantitative benchmarks or subjectively based upon certain events or particular circumstances. It is Old National's policy to charge off small commercial loans scored through our small business credit center with contractual balances under \$250,000 that have been placed on nonaccrual status or became ninety days or more delinquent, without regard to the collateral position. For residential and consumer loans, a charge off is recorded at the time foreclosure is initiated or when the loan becomes 120 to 180 days past due, whichever is earlier.

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

## Table of Contents

For consumer and residential troubled debt restructurings, an additional amount is added to the loan loss reserve that represents the difference in the present value of the cash flows between the original terms and the new terms of the modified loan, using the original effective interest rate of the loan as a discount rate.

At September 30, 2012, our troubled debt restructurings consisted of \$9.9 million of commercial loans, \$18.3 million of commercial real estate loans, \$0.3 million of consumer loans and \$0.3 million of residential loans, totaling \$28.8 million. Approximately \$16.6 million of the troubled debt restructuring at September 30, 2012 were included with nonaccrual loans. As of September 30, 2012, Old National had allocated specific reserves of \$2.9 million to commercial loans and \$1.2 million to commercial real estate loans for loans that have been modified in troubled debt restructurings. At December 31, 2011, our troubled debt restructurings consisted of \$7.1 million of commercial loans, \$5.8 million of commercial real estate loans and \$0.1 million of consumer loans, totaling \$13.0 million. Approximately \$11.7 million of the troubled debt restructuring at December 31, 2011 were included with nonaccrual loans. As of December 31, 2011, Old National had allocated specific reserves of \$1.3 million to commercial loans and \$0.2 million to commercial real estate loans for loans that have been modified in troubled debt restructurings.

The terms of certain other loans were modified during the nine months ended September 30, 2012 that did not meet the definition of a troubled debt restructuring. It is our process to review all classified and criticized loans that, during the period, have been renewed, have entered into a forbearance agreement, have gone from principal and interest to interest only, or have extended the maturity date. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on its debt in the foreseeable future without the modification. The evaluation is performed under the Company's internal underwriting policy. We also evaluate whether a concession has been granted or if we were adequately compensated through a market interest rate, additional collateral or a bona fide guarantee. We also consider whether the modification was insignificant relative to the other terms of the agreement or if the delay in a payment was 90 days or less.

Purchased credit impaired ( PCI ) loans would not be considered impaired until after the point at which there has been a degradation of cash flows below our expected cash flows at acquisition. If a PCI loan is subsequently modified, and meets the definition of a TDR, it will be removed from PCI accounting and accounted for as a TDR only if the PCI loan was being accounted for individually. If the purchased credit impaired loan is being accounted for as part of a pool, it will not be removed from the pool.

In general, once a modified loan is considered a TDR, the loan will always be considered a TDR, and therefore impaired, until it is paid in full, otherwise settled, sold or charged off. However, our policy also permits for loans to be removed from troubled debt restructuring status in the years following the restructuring if the following two conditions are met: (1) The restructuring agreement specifies an interest rate equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk, and (2) the loan is not impaired based on the terms specified by the restructuring agreement.

### *Allowance for Loan Losses and Reserve for Unfunded Commitments*

Loan charge-offs, net of recoveries, totaled \$0.4 million for the three months ended September 30, 2012, as compared to \$4.6 million for the three months ended September 30, 2011. Net charge-offs for the nine months ended September 30, 2012 totaled \$6.1 million compared to \$13.2 million for the nine months ended September 30, 2011. Annualized, net charge-offs to average loans were 0.03% and 0.17% for the three and nine months ended September 30, 2012, as compared to 0.40% and 0.41% for the three and nine months ended September 30, 2011. Management will continue its efforts to reduce the level of non-performing loans and may consider the possibility of sales of troubled and non-performing loans, which could result in additional charge-offs to the allowance for loan losses.

To provide for the risk of loss inherent in extending credit, we maintain an allowance for loan losses. The determination of the allowance is based upon the size and current risk characteristics of the loan portfolio and includes an assessment of individual problem loans, actual loss experience, current economic events and regulatory guidance. At September 30, 2012, the allowance for loan losses was \$54.8 million, a decrease of \$10.7 million compared to \$65.5 million at September 30, 2011, and a decrease of \$3.3 million compared to \$58.1 million at December 31, 2011. Impacting the allowance for loan losses and provision expense in 2012 are the following factors: (1) the loss factors applied to our performing loan portfolio have decreased over time as charge-offs were substantially lower, (2) the continuing trend in improved credit quality, and (3) the percentage of our legacy loan portfolio consisting of those loans where higher loss factors are applied (commercial and commercial real estate) fell while the percentage of our loan portfolio consisting of those loans where lower loss factors are applied (residential loans) increased. As a percentage of total loans excluding loans held for sale, the allowance was 1.04% at September 30, 2012, compared to 1.35% at September 30, 2011, and 1.22% at December 31, 2011. The provision for loan losses for the nine months ended September 30, 2012, was \$2.8 million compared to \$6.4 million for the nine months ended September 30, 2011.



**Table of Contents**

Because the acquired loans from Monroe Bancorp, Integra Bank and Indiana Community Bancorp were recorded at fair value in accordance with ASC 805 at the date of acquisition, the credit risk is incorporated in the fair value recorded. No allowance for loan losses is recorded on the acquisition date. We would expect that as the fair value mark is accreted into income over future periods, a reserve will be established to absorb credit deterioration or adverse changes in expected cash flows. Through September 30, 2012, \$2.0 million and \$4.5 million had been reserved for these purchased credits from Monroe Bancorp and Integra Bank, respectively.

The following table provides additional details of the following components of the allowance for loan losses, including FAS 5 (Accounting for Contingencies), FAS 114 (Accounting by Creditors for Impairment of a Loan) and SOP 03-3 (Accounting for Certain Loans or Debt Securities Acquired in a Transfer):

(dollars in thousands)	Legacy		FAS 5	Covered FAS 114	Purchased Loans			
	FAS 5	FAS 114			SOP 03-3	FAS 5	FAS 114	SOP 03-3
Loan balance	\$ 3,873,395	\$ 54,597	\$ 116,317	\$ 439	\$ 332,033	\$ 744,610	\$ 23,529	\$ 98,246
Remaining purchase discount			10,308		149,704	37,562	11,004	57,345
Allowance, January 1, 2012	43,920	11,027			943	325	167	1,678
Charge-offs	(6,478)	(5,055)	(1,944)		(241)	(309)	(1,917)	(2,045)
Recoveries	4,740	4,392	1,374		(4)	123	735	482
Provision expense	(4,476)	199	570		3,636	(101)	937	2,084
Allowance, September 30, 2012	37,706	10,563			4,334	38	(78)	2,199

We maintain an allowance for losses on unfunded commercial lending commitments and letters of credit to provide for the risk of loss inherent in these arrangements. The allowance is computed using a methodology similar to that used to determine the allowance for loan losses, modified to take into account the probability of a drawdown on the commitment. The \$8.0 million reserve for unfunded loan commitments at September 30, 2012 is classified as a liability account on the balance sheet. The reserve for unfunded loan commitments was \$4.8 million at December 31, 2011. The higher reserve is the result of an increase in unfunded commitments, primarily due to the Indiana Community Bancorp acquisition.

**Market Risk**

Market risk is the risk that the estimated fair value of our assets, liabilities, and derivative financial instruments will decline as a result of changes in interest rates or financial market volatility, or that our net income will be significantly reduced by interest rate changes.

The objective of our interest rate management process is to maximize net interest income while operating within acceptable limits established for interest rate risk and maintaining adequate levels of funding and liquidity.

**Table of Contents**

Potential cash flows, sales, or replacement value of many of our assets and liabilities, especially those that earn or pay interest, are sensitive to changes in the general level of interest rates. This interest rate risk arises primarily from our normal business activities of gathering deposits and extending loans. Many factors affect our exposure to changes in interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships, and re-pricing characteristics of financial instruments. Our earnings can also be affected by the monetary and fiscal policies of the U.S. Government and its agencies, particularly the Federal Reserve Board. In managing interest rate risk, we, through the Funds Management Committee, a committee of the Board of Directors, establish guidelines, for asset and liability management, including measurement of short and long-term sensitivities to changes in interest rates. Based on the results of our analysis, we may use different techniques to manage changing trends in interest rates including:

adjusting balance sheet mix or altering interest rate characteristics of assets and liabilities;

changing product pricing strategies;

modifying characteristics of the investment securities portfolio; or

using derivative financial instruments, to a limited degree.

A key element in our ongoing process is to measure and monitor interest rate risk using a Net Interest Income at Risk simulation to model the interest rate sensitivity of the balance sheet and to quantify the impact of changing interest rates on the Company. The model quantifies the effects of various possible interest rate scenarios on projected net interest income over a one-year and a two-year cumulative horizon. The model assumes a semi-static balance sheet and measures the impact on net interest income relative to a base case scenario of hypothetical changes in interest rates over 24 months. The scenarios include prepayment assumptions, changes in the level of interest rates, the shape of the yield curve, and spreads between market interest rates in order to capture the impact from re-pricing, yield curve, option, and basis risks.

Results of our simulation modeling, which assumes an immediate, parallel shift in market interest rates, project that our net interest income could change as follows over one-year and two-year horizons, relative to our base case scenario.

Change in the Level of Interest Rates	Changes in Net Interest Income							
	One Year Horizon				Two Year Cumulative Horizon			
	9/30/2012		9/30/2011		9/30/2012		9/30/2011	
	\$ Change (000s)	% Change	\$ Change (000s)	% Change	\$ Change (000s)	% Change	\$ Change (000s)	% Change
+ 3.00%	<b>(15,498)</b>	<b>-5.80%</b>	(12,791)	-4.89%	<b>(11,354)</b>	<b>-2.14%</b>	(9,757)	-1.89%
+ 2.00%	<b>(7,522)</b>	<b>-2.82%</b>	(5,723)	-2.19%	<b>2,411</b>	<b>0.46%</b>	2,718	0.53%
+ 1.00%	<b>182</b>	<b>0.07%</b>	842	0.32%	<b>10,686</b>	<b>2.02%</b>	9,512	1.84%
- 1.00%	NA	NA	NA	NA	NA	NA	NA	NA

At September 30, 2012, our simulated exposure to an increase in interest rates shows that an immediate increase in rates of 1.00% will increase our net interest income by \$0.2 million (.07%) over a one year horizon compared to a flat interest rate scenario. Rate increases of 2.00% and 3.00% would cause net interest income to decline by \$7.5 million (-2.82%), and \$15.5 million (-5.80%) respectively. Over a two-year horizon, the model reflects increases in net interest income of \$10.7 million (2.02%) over base case, for the up 1.00%. For the up 2.00% scenario, net interest income increases by \$2.4 million (.46%) and, in an up 3.00% scenario, net interest income decreases \$11.4% million (-2.14%) compared to our base case scenario. As a result of the already low interest rate environment, we did not include a 1.00% falling scenario.

Although we acquired Integra Bank and Indiana Community Bancorp during this time horizon, from September 30, 2011 to September 30, 2012, the interest rate risk profile of the Company remained fairly steady. In an up 2.00% shock scenario, over a two-year cumulative horizon, net interest income is projected to increase by .46% as of September 30, 2012 compared to .53% at September 30, 2011. During this period we

## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

experienced a significant change in our funding mix as balances in checking, NOW, and savings accounts increased by approximately \$640 million, while balances in time deposits decreased by \$277 million. We also had \$163 million of subordinated debt either called or matured during this period. Finally, we experienced a significant increase in loans due in part to the acquisition of Integra and Indiana Community Bancorp and also in part due to our strategy of holding residential real estate mortgages on the balance sheet.

**Table of Contents**

The Company's interest rate risk modeling indicates that its net interest income would be negatively impacted by a scenario where short-term interest rates remain constant while long-term rates (10 year through 30 year points on the curve) decrease by 1% (flattening of the yield curve). Assuming such a scenario with a semi-static balance sheet, the Company's net income will decrease by \$3.6 million (-1.35%) in year one and \$7.6 million (-2.90%) in year two compared to the flat interest rate scenario. This decrease in net interest income is primarily due to new or re-pricing assets being acquired or re-priced on the balance sheet at lower interest rate levels while the interest rates on much of the deposits and borrowings funding these assets have already re-priced to low levels.

We continue to execute strategies to position the Company in the current low rate environment to be relatively neutral to interest rate increases. For example, the investment portfolio has a relatively short duration at the same time management has increased its holdings of fixed-rate, residential real estate mortgages. Modeling results as of September 30, 2012, indicate that we remain within our Company's acceptable risk tolerance levels.

Old National also has longer term interest rate risk exposure, which may not be appropriately measured by Net Interest Income at Risk modeling. We use Economic Value of Equity (EVE) sensitivity analysis to evaluate the impact of long term cash flows on earnings and capital. EVE modeling involves discounting present values of all cash flows for on balance sheet and off balance sheet items under different interest rate scenarios. The discounted present value of all cash flows represents our economic value of equity. The amount of base case economic value and its sensitivity to shifts in interest rates provide a measure of the longer term re-pricing and option risk in the balance sheet. EVE simulation results are shown below, relative to base case.

Immediate Change in the Level of Interest Rates	Economic Value of Equity			
	9/30/2012		9/30/2011	
	\$ Change (millions)	% Change	\$Change (millions)	% Change
+ 3.00%	<b>85</b>	<b>14.03%</b>	6	0.86%
+ 2.00%	<b>100</b>	<b>16.49%</b>	20	2.90%
+ 1.00%	<b>99</b>	<b>16.35%</b>	50	7.42%
- 1.00%	<b>NA</b>	<b>NA</b>	NA	NA

At September 30, 2012, Old National's Economic Value of Equity (EVE) scenarios indicated a positive change to EVE in the up 1.00%, 2.00%, and 3.00% scenarios. These changes in EVE modeling results were driven primarily by the acquisition of Integra Bank and Indiana Community Bancorp and changes in the mix of the balance sheet, specifically the large increase in demand and savings deposits. The value of these deposits (which are carried as liabilities) are assumed to decrease in value to a greater degree than our less rate sensitive assets on our balance sheet, under rising rate scenarios. Modeling results at September 30, 2012, indicate that we remain within our Company's acceptable risk tolerance levels.

Because the models are driven by expected behavior in various interest rate scenarios and many factors besides market interest rates affect our net interest income and value, we recognize that model outputs are not guarantees of actual results. For this reason, we model many different combinations of interest rates and balance sheet assumptions to understand its overall sensitivity to market interest rate changes.

We use derivatives, primarily interest rate swaps, as one method to manage interest rate risk in the ordinary course of business. We also provide derivatives to our commercial customers in connection with managing interest rate risk. Our derivatives had an estimated fair value gain of \$7.4 million at September 30, 2012, compared to an estimated fair value gain of \$7.1 million at December 31, 2011. In addition, the notional amount of derivatives decreased by \$106.4 million from December 31, 2011, primarily as a result of the maturity of \$100 million of cash flow hedges in February 2012. See Note 17 to the consolidated financial statements for further discussion of derivative financial instruments.



**Table of Contents****Liquidity Risk**

Liquidity risk arises from the possibility that we may not be able to satisfy current or future financial commitments, or may become unduly reliant on alternative funding sources. The Funds Management Committee of the Board of Directors establishes liquidity risk guidelines and, along with the Balance Sheet Management Committee, monitors liquidity risk. The objective of liquidity management is to ensure we have the ability to fund balance sheet growth and meet deposit and debt obligations in a timely and cost-effective manner. Management monitors liquidity through a regular review of asset and liability maturities, funding sources, and loan and deposit forecasts. We maintain strategic and contingency liquidity plans to ensure sufficient available funding to satisfy requirements for balance sheet growth, properly manage capital markets funding sources and to address unexpected liquidity requirements.

Loan repayments and maturing investment securities are a relatively predictable source of funds. However, deposit flows, calls of investment securities and prepayments of loans and mortgage-related securities are strongly influenced by interest rates, the housing market, general and local economic conditions, and competition in the marketplace. We continually monitor marketplace trends to identify patterns that might improve the predictability of the timing of deposit flows or asset prepayments.

Our ability to acquire funding at competitive prices is influenced by rating agencies' views of our credit quality, liquidity, capital and earnings. All of the rating agencies place us in an investment grade that indicates a low risk of default. For both Old National and Old National Bank:

- Fitch Rating Service affirmed its long-term outlook rating as stable (unchanged) during the latest rating review on October 17, 2012
- Dominion Bond Rating Services has confirmed a stable outlook as of October 12, 2012
- Moody's Investor Service downgraded Old National Bank's Long Term Rating from A1 to A2 and changed its outlook from Negative to Stable on November 1, 2011. Old National Bank's Short Term Rating was unchanged.

The senior debt ratings of Old National and Old National Bank at September 30, 2012, are shown in the following table.

**SENIOR DEBT RATINGS**

	Moody's Investor Service		Fitch, Inc.		Dominion Bond Rating Svc.	
	Long term	Short term	Long term	Short term	Long term	Short term
Old National Bancorp	N/A	N/A	BBB	F2	BBB (high)	R-2 (high)
Old National Bank	A2	P-1	BBB+	F2	A (low)	R-1 (low)

N/A = not applicable

As of September 30, 2012, Old National Bank had the capacity to borrow \$705.4 million from the Federal Reserve Bank's discount window. Old National Bank is also a member of the Federal Home Loan Bank (FHLB) of Indianapolis, which provides a source of funding through FHLB advances. Old National Bank maintains relationships in capital markets with brokers and dealers to issue certificates of deposit and short-term and medium-term bank notes as well.

The Parent Company has routine funding requirements consisting primarily of operating expenses, dividends to shareholders, debt service, net derivative cash flows and funds used for acquisitions. The Parent Company can obtain funding to meet its obligations from dividends and management fees collected from its subsidiaries, operating line of credit and through the issuance of debt securities. Additionally, the Parent Company has a shelf registration in place with the Securities and Exchange Commission permitting ready access to the public debt and equity markets. At September 30, 2012, the Parent Company's other borrowings outstanding were \$28.0 million, a net decrease of \$1.0 million from December 31, 2011. This decrease was the result of the Parent Company calling \$13.0 million of subordinated debt and \$3.0 million of trust preferred securities on June 30, 2012, while adding \$15.0 million of Indiana Community Bancorp's trust preferred securities on September 15, 2012.

## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

Old National opted in to the Temporary Account Guarantee Program (TAGP) offered in 2008 as a part of Federal Deposit Insurance Corporation's (FDIC) Temporary Liquidity Guarantee Program (TLGP). The coverage under the TAGP program has been made permanent and all funds in a noninterest-bearing transaction account are insured in full by the FDIC through December 31, 2012. This unlimited coverage is in addition to, and separate from, the coverage of at least \$250,000 available to depositors under the FDIC's general deposit insurance rules.

**Table of Contents**

Federal banking laws regulate the amount of dividends that may be paid by banking subsidiaries without prior approval. Prior regulatory approval is required if dividends to be declared in any year would exceed net earnings of the current year plus retained net profits for the preceding two years. During the first quarter of 2009 Old National received a \$40 million dividend from the Bank Subsidiary to repurchase the \$100 million of non-voting preferred shares from the Treasury. In order to pay this special dividend, Old National Bank was required to seek approval from its regulatory authority. Such approval was also obtained for the payment of dividends during 2010 and 2011. Prior regulatory approval to pay dividends is not required in 2012.

**OFF-BALANCE SHEET ARRANGEMENTS**

Off-balance sheet arrangements include commitments to extend credit and financial guarantees. Commitments to extend credit and financial guarantees are used to meet the financial needs of our customers. Our banking affiliates have entered into various agreements to extend credit, including loan commitments of \$1.339 billion and standby letters of credit of \$69.4 million at September 30, 2012. At September 30, 2012, approximately \$1.281 billion of the loan commitments had fixed rates and \$58 million had floating rates, with the floating rates ranging from 0% to 21%. At December 31, 2011, loan commitments were \$1.220 billion and standby letters of credit were \$73.3 million. The term of these off-balance sheet arrangements is typically one year or less.

During the second quarter of 2007, we entered into a risk participation in an interest rate swap. The interest rate swap had a notional amount of \$8.7 million at September 30, 2012.

**CONTRACTUAL OBLIGATIONS**

The following table presents our significant fixed and determinable contractual obligations at September 30, 2012:

**CONTRACTUAL OBLIGATIONS**

(dollars in thousands)	Payments Due In				Total
	One Year or Less (1)	One to Three Years	Three to Five Years	Over Five Years	
Deposits without stated maturity	\$ 5,860,290	\$	\$	\$	\$ 5,860,290
IRAs, consumer and brokered certificates of deposit	183,849	890,626	240,978	45,634	1,361,087
Short-term borrowings	452,060				452,060
Other borrowings	13	167,890	34,176	86,423	288,502
Fixed interest payments (2)	2,413	14,670	8,160	26,433	51,676
Operating leases	8,292	62,198	57,896	270,681	399,067
Other long-term liabilities (3)	11,972				11,972

- (1) For the remaining three months of fiscal 2012.
- (2) Our subordinated notes, certain trust preferred securities and certain Federal Home Loan Bank advances have fixed rates ranging from 1.24% to 8.34%. All of our other long-term debt is at Libor based variable rates at September 30, 2012. The projected variable interest assumes no increase in Libor rates from September 30, 2012.
- (3) Old National assumed Indiana Bank and Trust's Pentegra Defined Benefit Plan for Financial Institutions. Old National has given notice to withdraw from the plan and has recorded an \$11.7 million termination liability. Remainder is amount expected to be contributed to Old National pension plans in 2012. Amounts for 2013 and beyond are unknown at this time.

We rent certain premises and equipment under operating leases. See Note 18 to the consolidated financial statements for additional information on long-term lease arrangements.

We are party to various derivative contracts as a means to manage the balance sheet and our related exposure to changes in interest rates, to manage our residential real estate loan origination and sale activity, and to provide derivative contracts to our clients. Since the derivative liabilities recorded on the balance sheet change frequently and do not represent the amounts that may ultimately be paid under these contracts, these liabilities are not included in the table of contractual obligations presented above. Further discussion of derivative instruments is included in Note 17 to the consolidated financial statements.



## Table of Contents

In the normal course of business, various legal actions and proceedings are pending against us and our affiliates which are incidental to the business in which they are engaged. Further discussion of contingent liabilities is included in Note 18 to the consolidated financial statements.

In addition, liabilities recorded under FASB ASC 740-10 (FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*) are not included in the table because the amount and timing of any cash payments cannot be reasonably estimated. Further discussion of income taxes and liabilities recorded under FASB ASC 740-10 is included in Note 16 to the consolidated financial statements.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our accounting policies are described in Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011. Certain 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. We consider these policies to be critical accounting policies. The judgment and assumptions made are based upon historical experience 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 affect 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 the Audit Committee of our Board.

### Goodwill and Intangibles

**Description.** For acquisitions, we are required to record the assets acquired, including identified intangible assets, and the liabilities assumed at their fair value. These often involve estimates based on third-party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques that may include estimates of attrition, inflation, asset growth rates or other relevant factors. In addition, the determination of the useful lives over which an intangible asset will be amortized is subjective. Under FASB ASC 350 (SFAS No. 142 *Goodwill and Other Intangible Assets*), goodwill and indefinite-lived assets recorded must be reviewed for impairment on an annual basis, as well as on an interim basis if events or changes indicate that the asset might be impaired. An impairment loss must be recognized for any excess of carrying value over fair value of the goodwill or the indefinite-lived intangible asset.

**Judgments and Uncertainties.** The determination of fair values is based on internal valuations using management's assumptions of future growth rates, future attrition, discount rates, multiples of earnings or other relevant factors.

**Effect if Actual Results Differ From Assumptions.** Changes in these factors, as well as downturns in economic or business conditions, could have a significant adverse impact on the carrying values of goodwill or intangible assets and could result in impairment losses affecting the financials of the Company as a whole and the individual lines of business in which the goodwill or intangibles reside.

### Acquired Impaired Loans

**Description.** Loans acquired with evidence of credit deterioration since inception and for which it is probable that all contractual payments will not be received are accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). These loans are recorded at fair value at the time of acquisition, with no carryover of the related allowance for loan losses. Fair value of acquired loans is determined using a discounted cash flow methodology based on assumptions about the amount and timing of principal and interest payments, principal prepayments and principal defaults and losses, and current market rates. In recording the acquisition date fair values of acquired impaired loans, management calculates a non-accretable difference (the credit component of the purchased loans) and an accretable difference (the yield component of the purchased loans).



## **Table of Contents**

Over the life of the acquired loans, the Company continues to estimate cash flows expected to be collected on pools of loans sharing common risk characteristics, which are treated in the aggregate when applying various valuation techniques. The Company evaluates at each balance sheet date whether the present value of its pools of loans determined using the effective interest rates has decreased significantly and if so, recognizes a provision for loan loss in its consolidated statement of income. For any significant increases in cash flows expected to be collected, the Company adjusts the amount of accretable yield recognized on a prospective basis over the pool's remaining life.

**Judgments and Uncertainties.** These cash flow evaluations are inherently subjective as they require management to make estimates about expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change.

**Effect if Actual Results Differ From Assumptions.** Changes in these factors, as well as changing economic conditions will likely impact the carrying value of these acquired loans as well as the carrying value of any associated indemnification assets, as the FDIC will reimburse the Company for losses incurred on certain acquired loans, but the shared-loss agreements may not fully offset the financial effects of such a situation.

## **Allowance for Loan Losses**

**Description.** The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, pools of homogeneous loans, assessments of the impact of current and anticipated economic conditions on the portfolio and historical loss experience. The allowance represents management's best estimate, but significant downturns in circumstances relating to loan quality and economic conditions could result in a requirement for additional allowance. Likewise, an upturn in loan quality and improved economic conditions may allow a reduction in the required allowance. In either instance, unanticipated changes could have a significant impact on results of operations.

The allowance is increased through a provision charged to operating expense. Uncollectible loans are charged-off through the allowance. Recoveries of loans previously charged-off are added to the allowance. A loan is considered impaired when it is probable that contractual interest and principal payments will not be collected either for the amounts or by the dates as scheduled in the loan agreement. Our policy for recognizing income on impaired loans is to accrue interest unless a loan is placed on nonaccrual status. A loan is generally placed on nonaccrual status when principal or interest becomes 90 days past due unless it is well secured and in the process of collection, or earlier when concern exists as to the ultimate collectibility of principal or interest. We monitor the quality of our loan portfolio on an on-going basis and use a combination of detailed credit assessments by relationship managers and credit officers, historic loss trends, and economic and business environment factors in determining the allowance for loan losses. We record provisions for loan losses based on current loans outstanding, grade changes, mix of loans and expected losses. A detailed loan loss evaluation on an individual loan basis for our highest risk loans is performed quarterly. Management follows the progress of the economy and how it might affect our borrowers in both the near and the intermediate term. We have a formalized and disciplined independent loan review program to evaluate loan administration, credit quality and compliance with corporate loan standards. This program includes periodic reviews and regular reviews of problem loan reports, delinquencies and charge-offs.

**Table of Contents**

**Judgments and Uncertainties.** We use migration analysis as a tool to determine the adequacy of the allowance for loan losses for performing commercial loans. Migration analysis is a statistical technique that attempts to estimate probable losses for existing pools of loans by matching actual losses incurred on loans back to their origination. Judgment is used to select and weight the historical periods which are most representative of the current environment.

We calculate migration analysis using several different scenarios based on varying assumptions to evaluate the widest range of possible outcomes. The migration-derived historical commercial loan loss rates are applied to the current commercial loan pools to arrive at an estimate of probable losses for the loans existing at the time of analysis. The amounts determined by migration analysis are adjusted for management's best estimate of the effects of current economic conditions, loan quality trends, results from internal and external review examinations, loan volume trends, credit concentrations and various other factors.

We use historic loss ratios adjusted for expectations of future economic conditions to determine the appropriate level of allowance for consumer and residential real estate loans.

**Effect if Actual Results Differ From Assumptions.** The allowance represents management's best estimate, but significant downturns in circumstances relating to loan quality and economic conditions could result in a requirement for additional allowance. Likewise, an upturn in loan quality and improved economic conditions may allow a reduction in the required allowance. In either instance, unanticipated changes could have a significant impact on results of operations.

Management's analysis of probable losses in the portfolio at September 30, 2012, resulted in a range for allowance for loan losses of \$10.2 million. The range pertains to general (FASB ASC 310, Receivables/SFAS 5) reserves for both retail and performing commercial loans. Specific (FASB ASC 310, Receivables/SFAS 114) reserves do not have a range of probable loss. Due to the risks and uncertainty associated with the economy, our projection of FAS 5 loss rates inherent in the portfolio, and our selection of representative historical periods, we establish a range of probable outcomes (a high-end estimate and a low-end estimate) and evaluate our position within this range. The potential effect to net income based on our position in the range relative to the high and low endpoints is a decrease of \$1.5 million and an increase of \$5.1 million, respectively, after taking into account the tax effects. These sensitivities are hypothetical and are not intended to represent actual results.

**Derivative Financial Instruments**

**Description.** As part of our overall interest rate risk management, we use derivative instruments to reduce exposure to changes in interest rates and market prices for financial instruments. The application of the hedge accounting policy requires judgment in the assessment of hedge effectiveness, identification of similar hedged item groupings and measurement of changes in the fair value of derivative financial instruments and hedged items. To the extent hedging relationships are found to be effective, as determined by FASB ASC 815 (SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*), changes in fair value of the derivatives are offset by changes in the fair value of the related hedged item or recorded to other comprehensive income. Management believes hedge effectiveness is evaluated properly in preparation of the financial statements. All of the derivative financial instruments we use have an active market and indications of fair value can be readily obtained. We are not using the short-cut method of accounting for any fair value derivatives.

**Judgments and Uncertainties.** The application of the hedge accounting policy requires judgment in the assessment of hedge effectiveness, identification of similar hedged item groupings and measurement of changes in the fair value of derivative financial instruments and hedged items.

**Effect if Actual Results Differ From Assumptions.** To the extent hedging relationships are found to be effective, as determined by FASB ASC 815 (SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*), changes in fair value of the derivatives are offset by changes in the fair value of the related hedged item or recorded to other comprehensive income. However, if in the future the derivative financial instruments used by us no longer qualify for hedge accounting treatment, all changes in fair value of the derivative would flow through the consolidated statements of income in other noninterest income, resulting in greater volatility in our earnings.



---

## Table of Contents

### Income Taxes

**Description.** We are subject to the income tax laws of the U.S., its states and the municipalities in which we operate. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant government taxing authorities. We review income tax expense and the carrying value of deferred tax assets quarterly; and as new information becomes available, the balances are adjusted as appropriate. FASB ASC 740-10 (FIN 48) prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. See Note 16 to the Consolidated Financial Statements for a further description of our provision and related income tax assets and liabilities.

**Judgments and Uncertainties.** In establishing a provision for income tax expense, we must make judgments and interpretations about the application of these inherently complex tax laws. We must also make estimates about when in the future certain items will affect taxable income in the various tax jurisdictions. Disputes over interpretations of the tax laws may be subject to review/adjudication by the court systems of the various tax jurisdictions or may be settled with the taxing authority upon examination or audit.

**Effect if Actual Results Differ From Assumptions.** Although management believes that the judgments and estimates used are reasonable, actual results could differ and we may be exposed to losses or gains that could be material. To the extent we prevail in matters for which reserves have been established, or are required to pay amounts in excess of our reserves, our effective income tax rate in a given financial statement period could be materially affected. An unfavorable tax settlement would result in an increase in our effective income tax rate in the period of resolution. A favorable tax settlement would result in a reduction in our effective income tax rate in the period of resolution.

### Valuation of Securities

**Description.** The fair value of our securities is determined with reference to price estimates. In the absence of observable market inputs related to items such as cash flow assumptions or adjustments to market rates, management judgment is used. Different judgments and assumptions used in pricing could result in different estimates of value.

When the fair value of a security is less than its amortized cost for an extended period, we consider whether there is an other-than-temporary-impairment in the value of the security. If, in management's judgment, an other-than-temporary-impairment exists, the portion of the loss in value attributable to credit quality is transferred from accumulated other comprehensive loss as an immediate reduction of current earnings and the cost basis of the security is written down by this amount.

We consider the following factors when determining an other-than-temporary-impairment for a security or investment:

The length of time and the extent to which the fair value has been less than amortized cost;

The financial condition and near-term prospects of the issuer;

The underlying fundamentals of the relevant market and the outlook for such market for the near future;

Our intent to sell the debt security or whether it is more likely than not that we will be required to sell the debt security before its anticipated recovery; and

Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

When applicable for purchased beneficial interests, the estimated cash flows of the securities are assessed for adverse changes.

## Table of Contents

Quarterly, securities are evaluated for other-than-temporary-impairment in accordance with FASB ASC 320 (SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*), and FASB ASC 325-10 (Emerging Issues Task Force No. 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets*) and FASB ASC 320-10 (FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*). An impairment that is an other-than-temporary-impairment is a decline in the fair value of an investment below its amortized cost attributable to factors that indicate the decline will not be recovered over the anticipated holding period of the investment. Other-than-temporary-impairments result in reducing the security's carrying value by the amount of credit loss. The credit component of the other-than-temporary-impairment loss is realized through the statement of income and the remainder of the loss remains in other comprehensive income.

**Judgments and Uncertainties.** The determination of other-than-temporary-impairment is a subjective process, and different judgments and assumptions could affect the timing and amount of loss realization. In addition, significant judgments are required in determining valuation and impairment, which include making assumptions regarding the estimated prepayments, loss assumptions and interest cash flows.

**Effect if Actual Results Differ From Assumptions.** Actual credit deterioration could be more or less severe than estimated. Upon subsequent review, if cash flows have significantly improved, the discount would be amortized into earnings over the remaining life of the debt security in a prospective manner based on the amount and timing of future cash flows. Additional credit deterioration resulting in an adverse change in cash flows would result in additional other-than-temporary impairment loss recorded in the income statement.

## **FORWARD-LOOKING STATEMENTS**

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

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

economic, market, operational, liquidity, credit and interest rate risks associated with our business;

economic conditions generally and in the financial services industry;

expected cost savings in connection with the consolidation of recent acquisitions may not be fully realized or realized within the expected time frames, and deposit attrition, customer loss and revenue loss following completed acquisitions may be greater than expected;

unexpected difficulties and losses related to FDIC-assisted acquisitions, including those resulting from our loss-sharing arrangements with the FDIC;

## Edgar Filing: OLD NATIONAL BANCORP /IN/ - Form 10-Q

increased competition in the financial services industry either nationally or regionally, resulting in, among other things, credit quality deterioration;

our ability to achieve loan and deposit growth;

volatility and direction of market interest rates;

governmental legislation and regulation, including changes in accounting regulation or standards;

our ability to execute our business plan;

a weakening of the economy which could materially impact credit quality trends and the ability to generate loans;

changes in the securities markets; and

changes in fiscal, monetary and tax policies.

## **Table of Contents**

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

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

See Management's Discussion and Analysis of Financial Condition and Results of Operations-Market Risk and Liquidity Risk.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Evaluation of disclosure controls and procedures. Old National's principal executive officer and principal financial officer have concluded that Old National's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended), based on their evaluation of these controls and procedures as of the end of the period covered by this Form 10-Q, are effective at the reasonable assurance level as discussed below to ensure that information required to be disclosed by Old National in the reports it files under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to Old National's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Limitations on the Effectiveness of Controls. Management, including the principal executive officer and principal financial officer, does not expect that Old National's disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be only reasonable assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, control may become inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in Internal Control over Financial Reporting. There were no changes in Old National's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, Old National's internal control over financial reporting.

**Table of Contents****PART II****OTHER INFORMATION****ITEM 1A. RISK FACTORS**

In addition to the risk factors disclosed in Old National's annual report on Form 10-K for the year ended December 31, 2011, the following risk factor may affect Old National's business, financial condition or results of operations. In analyzing whether to make or to continue an investment in Old National, investors should consider, among other factors, the risks highlighted below and in Old National's annual report.

**Risks Related to the Banking Industry**

*Old National Bank's ability to satisfy the conditions and obligations of the Consent Order it consented and agreed to with the Office of the Comptroller of the Currency ( OCC ).*

Old National Bank is subject to certain conditions and obligations of a Consent Order (the Order ) it consented and agreed to with the OCC, Old National Bank's federal banking regulator, relating to Old National Bank's Bank Secrecy Act/Anti-Money Laundering Program. Among other things, the Order requires the ongoing implementation of a system of internal controls, independent testing and training programs designed to ensure full compliance with the Bank Secrecy Act ( BSA ) and to review account and transaction activity to determine whether suspicious activity was timely identified and reported by Old National Bank. The OCC did not identify any systemic undetected criminal activity or money laundering and the Order does not call for the payment of a civil money penalty. While the Order is in effect, it may impact Old National's ability to obtain regulatory approval for merger and acquisition activity. While Old National Bank is implementing or has implemented corrective action for each deficiency and expects to satisfy all of the requirements of the Order in a timely fashion, material failure to comply with the Order could result in enforcement actions by the OCC, including the imposition of operating and expansion restrictions and monetary penalties.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****(c) ISSUER PURCHASES OF EQUITY SECURITIES**

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publically Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
07/01/12 - 07/31/12		\$		1,944,527
08/01/12 - 08/31/12				1,944,527
09/01/12 - 09/30/12	10,363	13.95	10,363	1,934,164
Quarter-to-date 09/30/12	10,363	\$ 13.95	10,363	1,934,164

On January 26, 2012, the Board of Directors approved the repurchase of up to 2.0 million shares of stock over a twelve month period beginning January 26, 2012 and ending January 31, 2013. During the first nine months of 2012, Old National repurchased a limited number of shares associated with employee share-based incentive programs but did not repurchase any shares on the open market.

**ITEM 5. OTHER INFORMATION**

(a) None

- (b) There have been no material changes in the procedure by which security holders recommend nominees to the Company's board of directors.

**Table of Contents****ITEM 6. EXHIBITS**

Exhibit No.	Description
2.1	Purchase and Assumption Agreement dated November 24, 2008 by and among Old National Bancorp, Old National Bank and RBS Citizens, National Association (incorporated by reference to Exhibit 2.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 25, 2008) and amended on March 20, 2009 (incorporated by reference to Exhibit 2.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 20, 2009).
2.2	Agreement and Plan of Merger dated as of October 5, 2010 by and among Old National Bancorp and Monroe Bancorp (the schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K) (incorporated by reference to Exhibit 2.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 6, 2010).
2.3	Purchase and Assumption Agreement Whole Bank All Deposits, among Federal Deposit Insurance Corporation, receiver of Integra Bank National Association, Evansville, Indiana, the Federal Deposit Insurance Corporation and Old National Bank, dated July 29, 2011 (incorporated by reference to Exhibit 2.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 4, 2011).
2.4	Agreement and Plan of Merger dated as of January 24, 2012 by and between Old National Bancorp and Indiana Community Bancorp (the schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K) (incorporated by reference to Exhibit 2.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 25, 2012).
3.1	Articles of Incorporation of Old National, amended December 10, 2008 (incorporated by reference to Exhibit 3.1 of Old National's Annual Report on Form 10-K for the year ended December 31, 2008).
3.2	By-Laws of Old National, amended July 23, 2009 (incorporated by reference to Exhibit 3.2 of Old National's Annual Report on Form 10-K for the year ended December 31, 2009).
4.1	Senior Indenture between Old National and The Bank of New York Trust Company (as successor to J.P. Morgan Trust Company, National Association (as successor to Bank One, NA)), as trustee, dated as of July 23, 1997 (incorporated by reference to Exhibit 4.3 to Old National's Registration Statement on Form S-3, Registration No. 333-118374, filed with the Securities and Exchange Commission on December 2, 2004).
4.2	Form of Indenture between Old National and J.P. Morgan Trust Company, National Association (as successor to Bank One, NA), as trustee (incorporated by reference to Exhibit 4.1 to Old National's Registration Statement on Form S-3, Registration No. 333-87573, filed with the Securities and Exchange Commission on September 22, 1999).
4.3	First Indenture Supplement dated as of May 20, 2005, between Old National and J.P. Morgan Trust Company, as trustee, providing for the issuance of its 5.00% Senior Notes due 2010 (incorporated by reference to Exhibit 4.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 20, 2005).
4.4	Form of 5.00% Senior Notes due 2010 (incorporated by reference to Exhibit 4.2 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 20, 2005).
10.1	Deferred Compensation Plan for Directors of Old National Bancorp and Subsidiaries (As Amended and Restated Effective as of January 1, 2003) (incorporated by reference to Exhibit 10(a) of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 15, 2004).*



**Table of Contents**

- 10.2 Second Amendment to the Deferred Compensation Plan for Directors of Old National Bancorp and Subsidiaries (As Amended and Restated Effective as of January 1, 2003) (incorporated by reference to Exhibit 10(b) of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 15, 2004).\*
- 10.3 2005 Directors Deferred Compensation Plan (Effective as of January 1, 2005) (incorporated by reference to Exhibit 10(c) of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 15, 2004).\*
- 10.4 Supplemental Deferred Compensation Plan for Select Executive Employees of Old National Bancorp and Subsidiaries (As Amended and Restated Effective as of January 1, 2003) (incorporated by reference to Exhibit 10(d) of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 15, 2004).\*
- 10.5 Second Amendment to the Supplemental Deferred Compensation Plan for Select Executive Employees of Old National Bancorp and Subsidiaries (As Amended and Restated Effective as of January 1, 2003) (incorporated by reference to Exhibit 10(e) of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 15, 2004).\*
- 10.6 Third Amendment to the Supplemental Deferred Compensation Plan for Select Executive Employees of Old National Bancorp and Subsidiaries (As Amended and Restated Effective as of January 1, 2003) (incorporated by reference to Exhibit 10(f) of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 15, 2004).\*
- 10.7 2005 Executive Deferred Compensation Plan (Effective as of January 1, 2005) (incorporated by reference to Exhibit 10(g) of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 15, 2004).\*
- 10.8 Summary of Old National Bancorp's Outside Director Compensation Program (incorporated by reference to Old National's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003).\*
- 10.9 Form of Executive Stock Option Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 10(h) of Old National's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004).\*
- 10.10 Form of 2006 Performance-Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 99.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 2, 2006).\*
- 10.11 Form of 2006 Service-Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 99.2 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 2, 2006).\*
- 10.12 Form of 2006 Non-qualified Stock Option Agreement (incorporated by reference to Exhibit 99.3 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 2, 2006).\*
- 10.13 Form of 2007 Performance-Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 10(w) of Old National's Annual Report on Form 10-K for the year ended December 31, 2006).\*
- 10.14 Form of 2007 Service-Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 10(x) of Old National's Annual Report on Form 10-K for the year ended December 31, 2006).\*

**Table of Contents**

- 10.15 Form of 2007 Non-qualified Stock Option Agreement between Old National and certain key associates (incorporated by reference to Exhibit 10(y) of Old National's Annual Report on Form 10-K for the year ended December 31, 2006).\*
- 10.16 Lease Agreement, dated December 20, 2006 between ONB One Main Landlord, LLC and Old National Bank (incorporated by reference to Exhibit 10(aa) of Old National's Annual Report on Form 10-K for the year ended December 31, 2006).
- 10.17 Lease Agreement, dated December 20, 2006 between ONB 123 Main Landlord, LLC and Old National Bank (incorporated by reference to Exhibit 10(ab) of Old National's Annual Report on Form 10-K for the year ended December 31, 2006).
- 10.18 Lease Agreement, dated December 20, 2006 between ONB 4<sup>th</sup> Street Landlord, LLC and Old National Bank (incorporated by reference to Exhibit 10(ac) of Old National's Annual Report on Form 10-K for the year ended December 31, 2006).
- 10.19 Master Lease Agreement dated September 19, 2007, by and between ONB CTL Portfolio Landlord #1, LLC, and Old National Bank (incorporated by reference to Exhibit 99.2 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 25, 2007).
- 10.20 Lease Supplement No. 1 dated September 19, 2007, by and between ONB CTL Portfolio Landlord #1, LLC, Old National Bank and ONB Insurance Group, Inc. (incorporated by reference to Exhibit 99.3 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 25, 2007).
- 10.21 Master Lease Agreement dated September 19, 2007, by and between ONB CTL Portfolio Landlord #2, LLC, and Old National Bank (incorporated by reference to Exhibit 99.4 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 25, 2007).
- 10.22 Master Lease Agreement dated September 19, 2007, by and between ONB CTL Portfolio Landlord #3, LLC, and Old National Bank (incorporated by reference to Exhibit 99.5 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 25, 2007).
- 10.23 Master Lease Agreement dated September 19, 2007, by and between ONB CTL Portfolio Landlord #4, LLC, and Old National Bank (incorporated by reference to Exhibit 99.6 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 25, 2007).
- 10.24 Master Lease Agreement dated September 19, 2007, by and between ONB CTL Portfolio Landlord #5, LLC, and Old National Bank (incorporated by reference to Exhibit 99.7 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 25, 2007).
- 10.25 Form of Lease Agreement dated October 19, 2007 entered into by affiliates of Old National Bancorp and affiliates of SunTrust Equity Funding, LLC (incorporated by reference to Exhibit 99.2 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 25, 2007).
- 10.26 Form of Lease Agreement dated December 27, 2007 entered into by affiliates of Old National Bancorp and affiliates of SunTrust Equity Funding, LLC (as incorporated by reference to Exhibit 99.2 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2007).
- 10.27 Form of 2008 Non-qualified Stock Option Award Agreement (incorporated by reference to Exhibit 99.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 30, 2008).\*

**Table of Contents**

- 10.28 Form of 2008 Performance-Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 99.2 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 30, 2008).\*
- 10.29 Form of 2008 Service-Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 99.3 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 30, 2008).\*
- 10.30 Old National Bancorp 2008 Incentive Compensation Plan (incorporated by reference to Appendix II of Old National's Definitive Proxy Statement filed with the Securities and Exchange Commission on March 27, 2008).\*
- 10.31 Old National Bancorp Code of Conduct (incorporated by reference to Exhibit 14.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 29, 2008).
- 10.32 Letter Agreement dated December 12, 2008 by and between Old National Bancorp and the United States Department of Treasury which includes the Securities Purchase Agreement Standard Terms (incorporated by reference to Exhibit 10.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 12, 2008).
- 10.33 Form of 2009 Performance Share Award Agreement Internal Performance Measures between Old National and certain key associates (incorporated by reference to Old National's Current Report on Form 8-K/A filed with the Securities and Exchange Commission on February 13, 2009).\*
- 10.34 Form of 2009 Performance Share Award Agreement Relative Performance Measures between Old National and certain key associates (incorporated by reference to Old National's Current Report on Form 8-K/A filed with the Securities and Exchange Commission on February 13, 2009).\*
- 10.35 Form of 2009 Service-Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Old National's Current Report on Form 8-K/A filed with the Securities and Exchange Commission on February 13, 2009).\*
- 10.36 Form of 2009 Executive Stock Option Agreement between Old National and certain key associates (incorporated by reference to Old National's Current Report on Form 8-K/A filed with the Securities and Exchange Commission on February 13, 2009).\*
- 10.37 Preferred Stock Repurchase Agreement dated March 31, 2009 by and between Old National Bancorp and the United States Department of Treasury (incorporated by reference to Exhibit 10.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 31, 2009).
- 10.38 Warrant Repurchase Agreement dated May 8, 2009 by and between Old National Bancorp and the United States Department of Treasury (incorporated by reference to Exhibit 10.1 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 11, 2009).
- 10.39 Stock Purchase and Dividend Reinvestment Plan (incorporated by reference to Old National's Registration Statement on Form S-3, Registration No. 333-161394 filed with the Securities and Exchange Commission on August 17, 2009).
- 10.40 Purchase Agreement dated September 17, 2009 between National City Commercial Capital Company, LLC, Old National Bank and Indiana Old National Insurance Company (incorporated by reference to Exhibit 10.01 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 18, 2009).
- 10.41 Servicing Agreement dated September 17, 2009 between National City Commercial Capital Company, LLC, Old National Bank and Indiana Old National Insurance Company (incorporated by reference to Exhibit 10.02 of Old National's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 18, 2009).

**Table of Contents**

10.42 Form of 2010 Performance Share Award Agreement Internal Performance Measures between Old National and certain key associates (incorporated by reference to Exhibit 10(as) of Old National s Annual Report on Form 10-K for the year ended December 31, 2009).\*

10.43 Form of 2010 Performance Share Award Agreement Relative Performance Measures between Old National and certain key associates (incorporated by reference to Exhibit 10(at) of Old National s Annual Report on Form 10-K for the year ended December 31, 2009).\*

10.44 Form of 2010 Service Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 10(au) of Old National s Annual Report on Form 10-K for the year ended December 31, 2009).\*

10.45 Voting agreement by and among directors of Monroe Bancorp (incorporated by reference to Exhibit 10.1 of Old National s Current Report on Form 8-K filed with the Securities and Exchange Commission on October 6, 2010).\*

10.46 Form of Employment Agreement for Robert G. Jones (incorporated by reference to Exhibit 10.1 of Old National s Current Report on Form 8-K filed with the Securities and Exchange Commission on January 27, 2011).\*

10.47 Form of Employment Agreement for Barbara A Murphy, Christopher A. Wolking, Allen R. Mounts and Daryl D. Moore (incorporated by reference to Exhibit 10.2 of Old National s Current Report on Form 8-K filed with the Securities and Exchange Commission on January 27, 2011).\*

10.48 Form of 2011 Performance Share Award Agreement Internal Performance Measures between Old National and certain key associates (incorporated by reference to Exhibit 10(av) of Old National s Annual Report on Form 10-K for the year ended December 31, 2010).\*

10.49 Form of 2011 Performance Share Award Agreement Relative Performance Measures between Old National and certain key associates (incorporated by reference to Exhibit 10(aw) of Old National s Annual Report on Form 10-K for the year ended December 31, 2010).\*

10.50 Form of 2011 Service Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 10(ax) of Old National s Annual Report on Form 10-K for the year ended December 31, 2010).\*

10.51 Old National Bank Cash-Settled Value Appreciation Instrument, dated July 29, 2011 (incorporated by reference to Exhibit 10.1 of Old National s Current Report on Form 8-K filed with the Securities and Exchange Commission on August 4, 2011).

10.52 Old National Bancorp 2011 Incentive Compensation Plan (incorporated by reference to Exhibit 10.52 of Old National s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011).\*

10.53 Voting agreement by and among directors of Indiana Community Bancorp (incorporated by reference to Exhibit 10(ba) of Old National s Annual Report on Form 10-K for the year ended December 31, 2011).\*

10.54 Form of Amended Severance/Change of Control Agreement for Jeffrey L. Knight (incorporated by reference to Exhibit 10(bb) of Old National s Annual Report on Form 10-K for the year ended December 31, 2011).\*

10.55 Form of 2012 Performance Share Award Agreement Internal Performance Measures between Old National and certain key associates (incorporated by reference to Exhibit 10(bc) of Old National s Annual Report on Form 10-K for the year ended December 31, 2011).\*

10.56 Form of 2012 Performance Share Award Agreement Relative Performance Measures between Old National and certain key associates (incorporated by reference to Exhibit 10(bd) of Old National s Annual Report on Form 10-K for the year ended December 31, 2011).\*

**Table of Contents**

10.57	Form of 2012 Service Based Restricted Stock Award Agreement between Old National and certain key associates (incorporated by reference to Exhibit 10(be) of Old National's Annual Report on Form 10-K for the year ended December 31, 2011).*
10.58	Old National Bancorp Amended and Restated 2008 Incentive Compensation Plan (incorporated by reference to Appendix I of Old National's Definitive Proxy Statement filed with the Securities and Exchange Commission on March 14, 2012).*
10.59	Stock Purchase and Dividend Reinvestment Plan (incorporated by reference to Old National's Registration Statement on Form S-3, Registration No. 333-183344 filed with the Securities and Exchange Commission on August 16, 2012).
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from Old National Bancorp's Form 10-Q Report for the quarterly period ended September 30, 2012, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements.**

\* Management contract or compensatory plan or arrangement

\*\* Furnished, not filed

**Table of Contents**

**SIGNATURES**

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

**OLD NATIONAL BANCORP**

(Registrant)

By: /s/ Christopher A. Wolking  
Christopher A. Wolking

Senior Executive Vice President and Chief Financial Officer

Duly Authorized Officer and Principal Financial Officer

Date: November 2, 2012