FIRST COMMONWEALTH FINANCIAL CORP /PA/
Form 10-Q
November 09, 2016

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, 2016
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 001-11138
First Commonwealth Financial Corporation
(Exact name of registrant as specified in its charter)

Pennsylvania	25-1428528
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
601 Philadelphia Street, Indiana, PA	15701
(Address of principal executive offices)	(Zip Code)

724-349-7220
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)
Indicate by a check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 x Accelerated filer ¨ Smaller reporting company ¨ Non-accelerated filer ¨
(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
The number of shares outstanding of issuer's common stock, $1.00 par value, as of November 8, 2016, was 88,992,077.

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FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Unaudited)

	September 30, 2016	December 31, 2015
	(dollars in thousands, except share data)	
Assets		
Cash and due from banks	$76,456	$66,644
Interest-bearing bank deposits	5,097	2,808
Securities available for sale, at fair value	813,659	886,560
Securities held to maturity, at amortized cost (Fair value of $396,994 and $382,341 at September 30, 2016 and December 31, 2015, respectively)	389,513	384,324
Other investments	54,066	62,952
Loans held for sale	7,855	5,763
Loans:		
Portfolio loans	4,860,652	4,683,750
Allowance for credit losses	(54,734)	(50,812)
Net loans	4,805,918	4,632,938
Premises and equipment, net	63,356	63,454
Other real estate owned	7,686	9,398
Goodwill	164,437	164,500
Amortizing intangibles, net	912	1,231
Bank owned life insurance	186,034	182,601
Other assets	91,494	103,717
Total assets	$6,666,483	$6,566,890
Liabilities		
Deposits (all domestic):		
Noninterest-bearing	$1,241,627	$1,116,689
Interest-bearing	3,217,353	3,079,205
Total deposits	4,458,980	4,195,894
Short-term borrowings	1,330,327	1,510,825
Subordinated debentures	72,167	72,167
Other long-term debt	8,892	9,314
Total long-term debt	81,059	81,481
Other liabilities	44,330	59,144
Total liabilities	5,914,696	5,847,344
Shareholders’ Equity		
Preferred stock, $1 par value per share, 3,000,000 shares authorized, none issued	—	—
Common stock, $1 par value per share, 200,000,000 shares authorized; 105,563,455 shares issued at September 30, 2016 and December 31, 2015, and 88,992,077 and 88,961,268 shares outstanding at September 30, 2016 and December 31, 2015, respectively	105,563	105,563
Additional paid-in capital	366,291	365,981
Retained earnings	401,079	378,081

Accumulated other comprehensive income (loss), net	6,762	(2,386)
Treasury stock (16,571,378 and 16,602,187 shares at September 30, 2016 and December 31, 2015, respectively)	(127,908)	(127,693)
Total shareholders’ equity	751,787	719,546
Total liabilities and shareholders’ equity	$6,666,483	$6,566,890

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

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ITEM 1. Financial Statements and Supplementary Data (Continued)
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
	(dollars in thousands, except share data)			
Interest Income				
Interest and fees on loans	$46,657	$ 43,083	$ 137,389	$ 128,334
Interest and dividends on investments:				
Taxable interest	6,763	6,470	20,937	20,022
Interest exempt from federal income taxes	380	261	1,112	646
Dividends	671	685	2,225	2,727
Interest on bank deposits	8	2	19	7
Total interest income	54,479	50,501	161,682	151,736
Interest Expense				
Interest on deposits	2,125	1,757	5,642	5,787
Interest on short-term borrowings	1,987	1,279	6,322	3,353
Interest on subordinated debentures	663	588	1,941	1,736
Interest on other long-term debt	86	192	261	633
Total interest expense	4,861	3,816	14,166	11,509
Net Interest Income	49,618	46,685	147,516	140,227
Provision for credit losses	3,408	4,621	20,306	8,818
Net Interest Income after Provision for Credit Losses	46,210	42,064	127,210	131,409
Noninterest Income				
Net securities gains	—	—	28	125
Trust income	1,523	1,614	4,098	4,511
Service charges on deposit accounts	3,975	4,081	11,528	11,271
Insurance and retail brokerage commissions	2,104	2,163	6,048	6,536
Income from bank owned life insurance	1,350	1,357	3,957	4,089
Gain on sale of mortgage loans	1,235	832	2,850	1,856
Gain on sale of other loans and assets	387	808	1,048	1,428
Card-related interchange income	3,698	3,637	11,039	10,784
Derivatives mark to market	470	(783)	(1,075)	(420)
Swap fee income	725	84	1,985	727
Other income	1,527	1,712	4,761	5,136
Total noninterest income	16,994	15,505	46,267	46,043
Noninterest Expense				
Salaries and employee benefits	20,647	22,446	62,212	66,339
Net occupancy expense	3,176	3,291	9,843	10,518
Furniture and equipment expense	2,847	2,670	8,596	7,980
Data processing expense	1,832	1,558	5,379	4,505
Advertising and promotion expense	750	789	1,940	1,946
Pennsylvania shares tax expense	914	1,713	2,764	3,617
Intangible amortization	67	157	318	469
Collection and repossession expense	760	801	1,803	2,229

Other professional fees and services	1,202	1,002	2,866	2,877
FDIC insurance	1,105	963	3,205	3,047
Loss on sale or write-down of assets	188	140	629	2,037
Litigation and operational losses	295	314	1,174	1,637
Merger and acquisition related	118	28	358	28
Other operating expenses	4,795	4,385	13,163	13,516
Total noninterest expense	38,696	40,257	114,250	120,745
Income Before Income Taxes	24,508	17,312	59,227	56,707
Income tax provision	7,312	4,898	17,551	16,625
Net Income	$17,196	$ 12,414	$41,676	$40,082
Average Shares Outstanding	88,854,448	88,807,294	88,842,143	89,527,560
Average Shares Outstanding Assuming Dilution	88,858,204	88,813,746	88,843,939	89,531,498
Per Share Data:				
Basic Earnings per Share	$0.19	$ 0.14	$0.47	$0.45
Diluted Earnings per Share	$0.19	$ 0.14	$0.47	$0.45
Cash Dividends Declared per Common Share	$0.07	$ 0.07	$0.21	$0.21

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

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ITEM 1. Financial Statements and Supplementary Data (Continued)
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
	(dollars in thousands)			
Net Income	$17,196	$12,414	$41,676	$40,082
Other comprehensive (loss) income, before tax benefit (expense):				
Unrealized holding (losses) gains on securities arising during the period	(751)	6,344	13,121	12,510
Less: reclassification adjustment for gains on securities included in net income	—	—	(28)	(125)
Unrealized holding (losses) gains on derivatives arising during the period	(1,056)	1,504	1,038	2,172
Less: reclassification adjustment for gains on derivatives included in net income	(16)	—	(57)	(6)
Total other comprehensive (loss) income, before tax benefit (expense)	(1,823)	7,848	14,074	14,551
Income tax benefit (expense) related to items of other comprehensive (loss) income	638	(2,747)	(4,926)	(5,091)
Total other comprehensive (loss) income	(1,185)	5,101	9,148	9,460
Comprehensive Income	$16,011	$17,515	$50,824	$49,542

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

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ITEM 1. Financial Statements and Supplementary Data (Continued)
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

	Shares Outstanding	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net	Treasury Stock	Total Shareholders' Equity
	(dollars in thousands, except share and per share data)						
Balance at December 31, 2015	88,961,268	$105,563	$365,981	$378,081	$ (2,386)	$(127,693)	$719,546
Net income				41,676			41,676
Other comprehensive income					9,148		9,148
Cash dividends declared ($0.21 per share)				(18,678)			(18,678)
Treasury stock acquired	(98,687)					(864)	(864)
Treasury stock reissued	23,148		39	—		177	216
Restricted stock	106,348	—	271	—		472	743
Balance at September 30, 2016	88,992,077	$105,563	$366,291	$401,079	$ 6,762	$(127,908)	$751,787

	Shares Outstanding	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net	Treasury Stock	Total Shareholders' Equity
	(dollars in thousands, except share and per share data)						
Balance at December 31, 2014	91,723,028	$105,563	$365,615	$353,027	$ (4,499)	$(103,561)	$716,145
Net income				40,082			40,082
Other comprehensive income					9,460		9,460
Cash dividends declared ($0.21 per share)				(18,862)			(18,862)
Treasury stock acquired	(2,918,066)					(25,383)	(25,383)
Treasury stock reissued	20,936		32	—		160	192
Restricted stock	135,370	—	303	—		831	1,134
Balance at September 30, 2015	88,961,268	$105,563	$365,950	$374,247	$ 4,961	$(127,953)	$722,768

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

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ITEM 1. Financial Statements and Supplementary Data (Continued)
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	For the Nine Months Ended September 30,	
	2016	2015
Operating Activities	(dollars in thousands)	
Net income	$41,676	$40,082
Adjustment to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	20,306	8,818
Deferred tax expense	4,332	12,520
Depreciation and amortization	5,234	5,750
Net gains on securities and other assets	(2,288)	(952)
Net amortization of premiums and discounts on securities	3,486	2,012
Income from increase in cash surrender value of bank owned life insurance	(3,957)	(4,089)
Increase in interest receivable	(50)	(167)
Mortgage loans originated for sale	(94,611)	(67,708)
Proceeds from sale of mortgage loans	95,341	67,071
Decrease in interest payable	(324)	(173)
Decrease in income taxes payable	(3,055)	(22)
Other-net	(6,200)	(10,757)
Net cash provided by operating activities	59,890	52,385
Investing Activities		
Transactions with securities held to maturity:		
Proceeds from maturities and redemptions	35,470	3,828
Purchases	(42,837)	(156,756)
Transactions with securities available for sale:		
Proceeds from sales	55,744	—
Proceeds from maturities and redemptions	122,828	286,924
Purchases	(94,777)	(16,600)
Purchases of FHLB stock	(31,218)	(46,911)
Proceeds from the redemption of FHLB stock	40,104	36,980
Proceeds from bank owned life insurance	203	378
Proceeds from sale of loans	3,511	2,898
Proceeds from sale of other assets	6,021	3,668
Net increase in loans	(200,269)	(140,268)
Purchases of other assets	(204)	—
Purchases of premises and equipment	(5,511)	(3,740)
Net cash used in investing activities	(110,935)	(29,599)
Financing Activities		
Net (decrease) increase in federal funds purchased	(1,000)	11,000
Net (decrease) increase in other short-term borrowings	(179,498)	212,918
Net increase (decrease) in deposits	263,392	(154,018)
Repayments of other long-term debt	(422)	(50,407)
Dividends paid	(18,678)	(18,862)

Proceeds from reissuance of treasury stock	216	192
Purchase of treasury stock	(864)	(25,383)
Net cash provided by (used in) financing activities	63,146	(24,560)
Net increase (decrease) in cash and cash equivalents	12,101	(1,774)
Cash and cash equivalents at January 1	69,452	74,538
Cash and cash equivalents at September 30	$81,553	$72,764

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.
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ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Note 1 Basis of Presentation
The accounting and reporting policies of First Commonwealth Financial Corporation and its subsidiaries (“First Commonwealth” or the “Company”) conform with generally accepted accounting principles in the United States of America (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. Actual realized amounts could differ from those estimates. In the opinion of management, the unaudited interim condensed consolidated financial statements include all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of First Commonwealth’s financial position, results of operations, comprehensive income, cash flows and changes in shareholders’ equity as of and for the periods presented.
The results of operations for the nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the full year of 2016. These interim financial statements should be read in conjunction with First Commonwealth’s 2015 Annual Report on Form 10-K.
For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and interest-bearing bank deposits. Generally, federal funds are sold for one-day periods.
Note 2 Supplemental Comprehensive Income Disclosures
The following table identifies the related tax effects allocated to each component of other comprehensive income (“OCI”) in the Condensed Consolidated Statements of Comprehensive Income. Reclassification adjustments related to securities available for sale are included in the "Net securities gains" line and reclassification adjustments related to losses on derivatives are included in the "Other operating expenses" line in the Condensed Consolidated Statements of Income.

	For the Nine Months Ended September 30,					
	2016			2015		
	Pretax Amount	Tax (Expense) Benefit	Net of Tax Amount	Pretax Amount	Tax (Expense) Benefit	Net of Tax Amount
	(dollars in thousands)					
Unrealized gains on securities:						
Unrealized holding gains on securities arising during the period	$13,121	$(4,593)	$8,528	$12,510	$(4,377)	$8,133
Reclassification adjustment for gains on securities included in net income	(28)	10	(18)	(125)	44	(81)
Total unrealized gains on securities	13,093	(4,583)	8,510	12,385	(4,333)	8,052
Unrealized gains on derivatives:						
Unrealized holding gains on derivatives arising during the period	1,038	(363)	675	2,172	(760)	1,412
Reclassification adjustment for gains on derivatives included in net income	(57)	20	(37)	(6)	2	(4)
Total unrealized gains on derivatives	981	(343)	638	2,166	(758)	1,408
Total other comprehensive income	$14,074	$(4,926)	$9,148	$14,551	$(5,091)	$9,460

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the Three Months Ended September 30, 2016			2015		
	Pretax Amount	Tax (Expense) Benefit	Net of Tax Amount	Pretax Amount	Tax (Expense) Benefit	Net of Tax Amount
	(dollars in thousands)					
Unrealized (losses) gains on securities:						
Unrealized holding (losses) gains on securities arising during the period	$(751)	$ 262	$(489)	$6,344	$ (2,221)	$ 4,123
Reclassification adjustment for losses on securities included in net income	—	—	—	—	—	—
Total unrealized (losses) gains on securities	(751)	262	(489)	6,344	(2,221)	4,123
Unrealized (losses) gains on derivatives:						
Unrealized holding (losses) gains on derivatives arising during the period	(1,056)	370	(686)	1,504	(526)	978
Reclassification adjustment for gains on derivatives included in net income	(16)	6	(10)	—	—	—
Total unrealized (losses) gains on derivatives	(1,072)	376	(696)	1,504	(526)	978
Total other comprehensive (loss) income	$(1,823)	$ 638	$(1,185)	$7,848	$ (2,747)	$ 5,101

The following table details the change in components of OCI for the nine months ended September 30:

	2016				2015			
	Securities Available for Sale	Post-Retirement Obligation	Derivatives	Accumulated Other Comprehensive Income	Securities Available for Sale	Post-Retirement Obligation	Derivatives	Accumulated Other Comprehensive Income
	(dollars in thousands)							
Balance at December 31	$(2,956)	$ 10	$ 560	$ (2,386)	$(4,875)	$ 76	$ 300	$ (4,499)
Other comprehensive income before reclassification adjustment	8,528	—	675	9,203	8,133	—	1,412	9,545
Amounts reclassified from accumulated other comprehensive (loss) income	(18)	—	(37)	(55)	(81)	—	(4)	(85)
Net other comprehensive income during the period	8,510	—	638	9,148	8,052	—	1,408	9,460
Balance at September 30	$5,554	$ 10	$ 1,198	$ 6,762	$3,177	$ 76	$ 1,708	$ 4,961

Note 3 Supplemental Cash Flow Disclosures

The following table presents information related to cash paid during the period for interest, as well as detail on non-cash investing and financing activities for the nine months ended September 30:

	2016	2015
	(dollars in thousands)	
Cash paid during the period for:		
Interest	$14,768	$11,682
Income taxes	15,750	4,000

Non-cash investing and financing activities:		
Loans transferred to other real estate owned and repossessed assets	3,973	7,413
Loans transferred from held to maturity to held for sale	3,573	3,071
Gross increase in market value adjustment to securities available for sale	13,094	12,381
Gross increase in market value adjustment to derivatives	981	2,167
Investments committed to purchase, not settled	276	1,350
Proceeds from death benefit on bank-owned life insurance not received	320	—

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4 Earnings per Share

The following table summarizes the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computations:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Weighted average common shares issued	105,563,455	105,563,455	105,563,455	105,563,455
Average treasury stock shares	(16,609,505)	(16,602,502)	(16,617,616)	(15,858,433)
Average unearned nonvested shares	(99,502)	(153,659)	(103,696)	(177,462)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	88,854,448	88,807,294	88,842,143	89,527,560
Additional common stock equivalents (nonvested stock) used to calculate diluted earnings per share	3,756	6,452	1,796	3,938
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	88,858,204	88,813,746	88,843,939	89,531,498

The following table shows the number of shares and the price per share related to common stock equivalents that were not included in the computation of diluted earnings per share for the nine months ended September 30 because to do so would have been antidilutive.

	2016			2015		
		Price Range			Price Range	
	Shares	From	To	Shares	From	To
Restricted Stock	72,432	$8.38	$10.09	121,091	$5.26	$9.84

Note 5 Commitments and Contingent Liabilities

Commitments and Letters of Credit

Standby letters of credit and commercial letters of credit are conditional commitments issued by First Commonwealth to guarantee the performance of a customer to a third party. The contract or notional amount of these instruments reflects the maximum amount of future payments that First Commonwealth could be required to pay under the guarantees if there were a total default by the guaranteed parties, without consideration of possible recoveries under recourse provisions or from collateral held or pledged. In addition, many of these commitments are expected to expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements.

The following table identifies the notional amount of those instruments at:

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$1,598,318	$1,643,187
Financial standby letters of credit	17,760	17,843
Performance standby letters of credit	28,110	26,497
Commercial letters of credit	1,528	1,672

The notional amounts outstanding as of September 30, 2016 include amounts issued in 2016 of $23 thousand in financial standby letters of credit, $2.9 million in performance standby letters of credit and $0.2 million commercial letters of credit. A liability of $0.2 million has been recorded as of both September 30, 2016 and December 31, 2015 which represents the estimated fair value of letters of credit issued. The fair value of letters of credit is estimated based on the unrecognized portion of fees received at the time the commitment was issued.

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Unused commitments and letters of credit provide exposure to future credit loss in the event of nonperformance by the borrower or guaranteed parties. Management's evaluation of the credit risk related to these commitments resulted in the recording of a liability of $4.0 million as of September 30, 2016 and $4.4 million as of December 31, 2015. This liability is reflected in "Other liabilities" in the Condensed Consolidated Statements of Financial Condition. The credit risk evaluation incorporated probability of default, loss given default and estimated utilization for the next twelve months for each loan category and the letters of credit.

Legal Proceedings

First Commonwealth and its subsidiaries are subject in the normal course of business to various pending and threatened legal proceedings in which claims for monetary damages are asserted. As of September 30, 2016, management, after consultation with legal counsel, does not anticipate that the aggregate ultimate liability arising out of litigation pending or threatened against First Commonwealth or its subsidiaries will be material to First Commonwealth's consolidated financial position. On at least a quarterly basis, First Commonwealth assesses its liabilities and contingencies in connection with such legal proceedings. For those matters where it is probable that First Commonwealth will incur losses and the amounts of the losses can be reasonably estimated, First Commonwealth records an expense and corresponding liability in its consolidated financial statements. To the extent the pending or threatened litigation could result in exposure in excess of that liability, the amount of such excess is not currently estimable. Although not considered probable, the range of reasonably possible losses for such matters in the aggregate, beyond the existing recorded liability (if any), is between $0 and $7 million. Although First Commonwealth does not believe that the outcome of pending litigation will be material to First Commonwealth's consolidated financial position, it cannot rule out the possibility that such outcomes will be material to the consolidated results of operations and cash flows for a particular reporting period in the future.

First Commonwealth Financial Corporation and First Commonwealth Bank were named defendants in an action commenced August 27, 2015 by eight named plaintiffs that is pending in the Court of Common Pleas of Jefferson County, Pennsylvania. The plaintiffs allege that the Bank repossessed motor vehicles, sold the vehicles and sought to collect deficiency balances in a manner that did not comply with the notice requirements of the Pennsylvania Uniform Commercial Code (UCC), charged inappropriate costs and fees, including storage costs for dates that a repossessed vehicle was not in storage, and wrongly filed forms with the Department of Motor Vehicles asserting that the Bank had complied with applicable laws relating to the repossession of the vehicles. The plaintiffs seek to pursue the action as a class action on behalf of the named plaintiffs and other similarly situated plaintiffs who had their automobiles repossessed and seek to recover damages under the UCC and the Pennsylvania Fair Credit Extension Uniformity Act. First Commonwealth and the Bank contest the plaintiffs' allegations and intend to oppose class certification. The Bank has also asserted counterclaims for breach of contract, set-off and recoupment against the plaintiffs, individually, and as representatives of the putative class. The Bank and counsel for the plaintiffs reached an agreement-in-principle to settle the litigation during the second quarter of 2016. The parties are negotiating the terms of a definitive settlement agreement which would be subject to court approval and other customary conditions. The estimated cost of the settlement to the Bank was recorded as a liability in the second quarter of 2016. As set forth in the preceding paragraph, all current litigation matters, including this action, are believed to be within the range of reasonably possible losses set forth in the preceding paragraph.

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6 Investment Securities
Securities Available for Sale
Below is an analysis of the amortized cost and estimated fair values of securities available for sale at:

	September 30, 2016				December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(dollars in thousands)							
Obligations of U.S. Government Agencies:								
Mortgage-Backed Securities – Residential	$16,059	$1,917	$—	$17,976	$20,034	$2,071	$(13)	$22,092
Obligations of U.S. Government-Sponsored Enterprises:								
Mortgage-Backed Securities – Residential	692,092	13,090	(556)	704,626	778,476	7,983	(8,882)	777,577
Mortgage-Backed Securities – Commercial	1	—	—	1	28	—	—	28
Other Government-Sponsored Enterprises	19,300	7	—	19,307	19,201	2	(85)	19,118
Obligations of States and Political Subdivisions	27,073	878	—	27,951	27,066	532	—	27,598
Corporate Securities	5,901	618	—	6,519	1,897	422	—	2,319
Pooled Trust Preferred Collateralized Debt Obligations	43,020	677	(8,088)	35,609	42,239	916	(7,497)	35,658
Total Debt Securities	803,446	17,187	(8,644)	811,989	888,941	11,926	(16,477)	884,390
Equities	1,670	—	—	1,670	2,170	—	—	2,170
Total Securities Available for Sale	$805,116	$17,187	$(8,644)	$813,659	$891,111	$11,926	$(16,477)	$886,560

Mortgage backed securities include mortgage backed obligations of U.S. Government agencies and obligations of U.S. Government-sponsored enterprises. These obligations have contractual maturities ranging from less than one year to approximately 30 years with lower anticipated lives to maturity due to prepayments. All mortgage backed securities contain a certain amount of risk related to the uncertainty of prepayments of the underlying mortgages. Interest rate changes have a direct impact upon prepayment speeds; therefore, First Commonwealth uses computer simulation models to test the average life and yield volatility of all mortgage backed securities under various interest rate scenarios to monitor the potential impact on earnings and interest rate risk positions.

Expected maturities will differ from contractual maturities because issuers may have the right to call or repay obligations with or without call or prepayment penalties. Other fixed income securities within the portfolio also contain prepayment risk.

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The amortized cost and estimated fair value of debt securities available for sale at September 30, 2016, by contractual maturity, are shown below.

	Amortized Cost	Estimated Fair Value
	(dollars in thousands)	
Due within 1 year	$5,600	$5,602
Due after 1 but within 5 years	17,697	17,756
Due after 5 but within 10 years	27,073	27,951
Due after 10 years	44,924	38,077
	95,294	89,386
Mortgage-Backed Securities (a)	708,152	722,603
Total Debt Securities	$803,446	$811,989

(a) Mortgage Backed Securities include an amortized cost of $16.1 million and a fair value of $18.0 million for Obligations of U.S. Government agencies issued by Ginnie Mae and an amortized cost of $692.1 million and a fair value of $704.6 million for Obligations of U.S. Government-sponsored enterprises issued by Fannie Mae and Freddie Mac.

Proceeds from sales, gross gains (losses) realized on sales, maturities and other-than-temporary impairment charges related to securities available for sale were as follows for the nine months ended September 30:

	2016	2015
	(dollars in thousands)	
Proceeds from sales	$ 55,744	$ —
Gross gains (losses) realized:		
Sales Transactions:		
Gross gains	$ 304	$ —
Gross losses	(276)	—
	28	—
Maturities and impairment		
Gross gains	—	125
Gross losses	—	—
Other-than-temporary impairment	—	—
	—	125
Net gains and impairment	$ 28	$ 125

Securities available for sale with an estimated fair value of $498.5 million and $416.1 million were pledged as of September 30, 2016 and December 31, 2015, respectively, to secure public deposits and for other purposes required or permitted by law.

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Securities Held to Maturity

Below is an analysis of the amortized cost and fair values of debt securities held to maturity at:

	September 30, 2016				December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(dollars in thousands)							
Obligations of U.S. Government Agencies:								
Mortgage-Backed Securities – Residential	$4,615	$ 154	$ —	$4,769	$4,775	$ —	$ (7)	$4,768
Mortgage-Backed Securities-Commercial	35,625	225	—	35,850	16,843	—	(247)	16,596
Obligations of U.S. Government-Sponsored Enterprises:								
Mortgage-Backed Securities – Residential	297,681	5,865	—	303,546	315,609	30	(1,824)	313,815
Mortgage-Backed Securities – Commercial	14,809	378	—	15,187	15,187	—	(178)	15,009
Obligations of States and Political Subdivisions	36,783	884	(25)	37,642	31,910	301	(58)	32,153
Total Securities Held to Maturity	$389,513	$ 7,506	$ (25)	$396,994	$384,324	$ 331	$ (2,314)	$382,341

The amortized cost and estimated fair value of debt securities held to maturity at September 30, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(dollars in thousands)	
Due within 1 year	$—	$—
Due after 1 but within 5 years	1,223	1,249
Due after 5 but within 10 years	29,368	30,125
Due after 10 years	6,192	6,268
	36,783	37,642
Mortgage-Backed Securities (a)	352,730	359,352
Total Debt Securities	$389,513	$396,994

(a) Mortgage Backed Securities include an amortized cost of $40.2 million and a fair value of $40.6 million for Obligations of U.S. Government agencies issued by Ginnie Mae and an amortized cost of $312.5 million and a fair value of $318.7 million for Obligations of U.S. Government-sponsored enterprises issued by Fannie Mae and Freddie Mac.

Securities held to maturity with an amortized cost of $281.9 million and $45.7 million were pledged as of September 30, 2016 and December 31, 2015, respectively, to secure public deposits and for other purposes required or permitted by law.

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Note 7 Impairment of Investment Securities
Securities Available for Sale and Held to Maturity
As required by FASB ASC Topic 320, "Investments – Debt and Equity Securities," credit-related other-than-temporary impairment on debt securities is recognized in earnings, while non-credit related other-than-temporary impairment on debt securities not expected to be sold is recognized in OCI. During the nine months ended September 30, 2016 and 2015, no other-than-temporary impairment charges were recognized.
First Commonwealth utilizes the specific identification method to determine the net gain or loss on debt securities and the average cost method to determine the net gain or loss on equity securities.
We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and whether we are more likely than not to sell, or be required to sell, the security. We evaluate whether we are more likely than not to sell debt securities based upon our investment strategy for the particular type of security, our cash flow needs, liquidity position, capital adequacy, tax position and interest rate risk position. In addition, the risk of future other-than-temporary impairment may be influenced by additional bank failures, weakness in the U.S. economy, changes in real estate values and additional interest deferrals in our pooled trust preferred collateralized debt obligations. Our pooled trust preferred collateralized debt obligations are beneficial interests in securitized financial assets within the scope of FASB ASC Topic 325, "Investments – Other," and are therefore evaluated for other-than-temporary impairment using management's best estimate of future cash flows. If these estimated cash flows indicate that it is probable that an adverse change in cash flows has occurred, then other-than-temporary impairment would be recognized in accordance with FASB ASC Topic 320. There is a risk that First Commonwealth will record other-than-temporary impairment charges in the future. See Note 10, "Fair Values of Assets and Liabilities," for additional information.
The following table presents the gross unrealized losses and estimated fair values at September 30, 2016 for both available for sale and held to maturity securities by investment category and time frame for which securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
	(dollars in thousands)					
Obligations of U.S. Government-Sponsored Enterprises:						
Mortgage-Backed Securities – Residential	$59,691	$ (137)	$60,909	$ (419)	$120,600	$ (556)
Obligations of States and Political Subdivisions	1,781	(25)	—	—	1,781	(25)
Pooled Trust Preferred Collateralized Debt Obligations	—	—	29,896	(8,088)	29,896	(8,088)
Total Securities	$61,472	$ (162)	$90,805	$ (8,507)	$152,277	$ (8,669)

At September 30, 2016, fixed income securities issued by U.S. Government-sponsored enterprises comprised 6% of total unrealized losses due to changes in market interest rates. Pooled trust preferred collateralized debt obligations accounted for 93% of the unrealized losses primarily due to the illiquid market for this investment type. At September 30, 2016, there are 22 debt securities in an unrealized loss position.

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The following table presents the gross unrealized losses and estimated fair values at December 31, 2015 by investment category and time frame for which securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
	(dollars in thousands)					
Obligations of U.S. Government Agencies:						
Mortgage-Backed Securities – Residential	$6,798	$(20)	$—	$—	$6,798	$(20)
Mortgage-Backed Securities - Commercial	16,596	(247)	—	—	16,596	(247)
Obligations of U.S. Government-Sponsored Enterprises:						
Mortgage-Backed Securities – Residential	436,011	(3,293)	263,119	(7,413)	699,130	(10,706)
Mortgage-Backed Securities – Commercial	15,009	(178)	—	—	15,009	(178)
Other Government-Sponsored Enterprises	12,316	(85)	—	—	12,316	(85)
Obligation of States and Political Subdivisions	7,208	(58)	—	—	7,208	(58)
Pooled Trust Preferred Collateralized Debt Obligations	—	—	29,957	(7,497)	29,957	(7,497)
Total Securities	$493,938	$(3,881)	$293,076	$(14,910)	$787,014	$(18,791)

As of September 30, 2016, our corporate securities had an amortized cost and an estimated fair value of $5.9 million and $6.5 million, respectively. As of December 31, 2015, our corporate securities had an amortized cost and estimated fair value of $1.9 million and $2.3 million, respectively. Corporate securities are comprised of debt for large regional banks. There were no corporate securities in an unrealized loss position as of September 30, 2016 and December 31, 2015. When unrealized losses exist on these investments, management reviews each of the issuer's asset quality, earnings trends and capital position, to determine whether issues in an unrealized loss position were other-than-temporarily impaired. All interest payments on the corporate securities are being made as contractually required.

As of September 30, 2016, the book value of our pooled trust preferred collateralized debt obligations totaled $43.0 million with an estimated fair value of $35.6 million, which includes securities comprised of 268 banks and other financial institutions. All of our pooled securities are mezzanine tranches, three of which have no senior class remaining in the issue. The credit ratings on all of our issues are below investment grade. At the time of initial issue, the subordinated tranches ranged in size from approximately 7% to 35% of the total principal amount of the respective securities and no more than 5% of any pooled security consisted of a security issued by any one institution. As of September 30, 2016, after taking into account management's best estimates of future interest deferrals and defaults, three of our securities had no excess subordination in the tranches we own and six of our securities had excess subordination which ranged from 2% to 82% of the current performing collateral.

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The following table provides information related to our pooled trust preferred collateralized debt obligations as of September 30, 2016:

Deal	Class	Book Value	Estimated Fair Value	Unrealized Gain (Loss)	Moody's/ Fitch Ratings	Number of Banks	Deferrals and Defaults as a % of Current Collateral	Excess Subordination as a % of Current Performing Collateral
(dollars in thousands)								
Pre TSL IV	Mezzanine	$1,830	$ 1,331	$ (499)	B1/BB	6	18.05 %	60.61 %
Pre TSL VII	Mezzanine	3,119	3,513	394	Ca/-	14	47.77	0.00
Pre TSL VIII	Mezzanine	2,063	2,025	(38)	C/C	28	44.37	0.00
Pre TSL IX	Mezzanine	2,403	1,893	(510)	B1/C	37	27.83	12.79
Pre TSL X	Mezzanine	1,707	1,887	180	Caa1/C	42	31.58	2.17
Pre TSL XII	Mezzanine	5,839	4,584	(1,255)	B3/C	64	24.50	0.00
Pre TSL XIII	Mezzanine	12,888	10,504	(2,384)	Ba3/C	54	11.75	48.41
Pre TSL XIV	Mezzanine	12,960	9,559	(3,401)	B1/CC	54	13.45	37.92
MMCap I	Mezzanine	211	313	102	Ca/C	8	58.11	81.65
Total		$43,020	$ 35,609	$ (7,411)				

Lack of liquidity in the market for trust preferred collateralized debt obligations, below investment grade credit ratings and market uncertainties related to the financial industry are factors contributing to the impairment on these securities.
In October 2016, the Company received notice that the Senior note holders of Pre TSL VII elected to liquidate all assets of the trust. The sale of the assets and early redemption of the security is anticipated to be completed in the fourth quarter of 2016. Estimated proceeds are expected to be in line with our book value.
All of the Company's pooled trust preferred securities are included in the non-exclusive list issued by the regulatory agencies and therefore are not considered covered funds under the Volcker Rule.
On a quarterly basis we evaluate our debt securities for other-than-temporary impairment. During the three and nine months ended September 30, 2016 and 2015, there were no credit-related other-than-temporary impairment charges recognized on our pooled trust preferred collateralized debt obligations. When evaluating these investments, we determine a credit-related portion and a non-credit related portion of other-than-temporary impairment. The credit-related portion is recognized in earnings and represents the difference between book value and the present value of future cash flows. The non-credit related portion is recognized in OCI and represents the difference between the fair value of the security and the amount of credit-related impairment. A discounted cash flow analysis provides the best estimate of credit-related other-than-temporary impairment for these securities.
Additional information related to the discounted cash flow analysis follows:
Our pooled trust preferred collateralized debt obligations are measured for other-than-temporary impairment within the scope of FASB ASC Topic 325 by determining whether it is probable that an adverse change in estimated cash flows has occurred. Determining whether there has been an adverse change in estimated cash flows from the cash flows previously projected involves comparing the present value of remaining cash flows previously projected against the present value of the cash flows estimated at September 30, 2016. We consider the discounted cash flow analysis to be our primary evidence when determining whether credit related other-than-temporary impairment exists.

Results of a discounted cash flow test are significantly affected by other variables, such as the estimate of future cash flows, credit worthiness of the underlying banks and determination of probability of default of the underlying collateral. The following provides additional information for each of these variables:

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Estimate of Future Cash Flows – Cash flows are constructed in an INTEX cash flow model which includes each deal's structural features. Projected cash flows include prepayment assumptions, which are dependent on the issuer's asset size and coupon rate. For collateral issued by financial institutions over $15 billion in asset size with a coupon over 7%, a 100% prepayment rate is assumed. Financial institutions over $15 billion with a coupon of 7% or under are assigned a prepayment rate of 40% for two years and 2% thereafter. Financial institutions with assets between $2 billion and $15 billion with coupons over 7% are assigned a 5% prepayment rate. For financial institutions below $2 billion, if the coupon is over 10%, a prepayment rate of 5% is assumed and for all other issuers, there is no prepayment assumption incorporated into the cash flows. The modeled cash flows are then used to estimate if all the scheduled principal and interest payments of our investments will be returned.

- Credit Analysis – A quarterly credit evaluation is performed for each of the 268 banks comprising the collateral across the various pooled trust preferred securities. Our credit evaluation considers all evidence available to us and includes the nature of the issuer's business, its years of operating history, corporate structure, loan composition, loan concentrations, deposit mix, asset growth rates, geographic footprint and local economic environment. Our analysis focuses on profitability, return on assets, shareholders' equity, net interest margin, credit quality ratios, operating efficiency, capital adequacy and liquidity.
- Probability of Default – A probability of default is determined for each bank and is used to calculate the expected impact of future deferrals and defaults on our expected cash flows. Each bank in the collateral pool is assigned a probability of default for each year until maturity. Currently, any bank that is in default is assigned a 100% probability of default and a 0% projected recovery rate. All other banks in the pool are assigned a probability of default based on their unique credit characteristics and market indicators with a 10% projected recovery rate. For the majority of banks currently in deferral we assume the bank continues to defer and will eventually default and, therefore, a 100% probability of default is assigned. However, for some deferring collateral there is the possibility that they will become current on interest or principal payments at some point in the future and in those cases a probability that the deferral will ultimately cure is assigned. The probability of default is updated quarterly. As of September 30, 2016, default probabilities for performing collateral ranged from 0.33% to 75%.

Our credit evaluation provides a basis for determining deferral and default probabilities for each underlying piece of collateral. Using the results of the credit evaluation, the next step of the process is to look at pricing of senior debt or credit default swaps for the issuer (or where such information is unavailable, for companies having similar credit profiles as the issuer). The pricing of these market indicators provides the information necessary to determine appropriate default probabilities for each bank.

In addition to the above factors, our evaluation of impairment also includes a stress test analysis which provides an estimate of excess subordination for each tranche. We stress the cash flows of each pool by increasing current default assumptions to the level of defaults that results in an adverse change in estimated cash flows. This stressed breakpoint is then used to calculate excess subordination levels for each pooled trust preferred security. The results of the stress test allow management to identify those pools that are at a greater risk for a future break in cash flows so that we can monitor banks in those pools more closely for potential deterioration of credit quality.

Our cash flow analysis as of September 30, 2016, indicates that no credit-related other-than-temporary impairment has occurred on our pooled trust preferred securities during the nine months ended September 30, 2016. Based upon the analysis performed by management, it is probable that three of our pooled trust preferred securities will experience principal and interest shortfalls and therefore appropriate other-than-temporary charges were recorded in prior periods. These securities are identified in the table on page 17 with 0.00% "Excess Subordination as a Percentage of Current Performing Collateral." For the remaining securities listed in that table, our analysis as of September 30, 2016 indicates it is probable that we will collect all contractual principal and interest payments. For four of those securities, PreTSL IX, PreTSL XIII, PreTSL XIV and MMCap I, other-than-temporary impairment charges were recorded in prior periods; however, due to improvement in the expected cash flows of these securities, it is now probable that all contractual payments will be received.

During 2008, 2009 and 2010, other-than-temporary impairment charges were recognized on all of our pooled trust preferred securities, except for PreTSL IV. Our cash flow analysis as of September 30, 2016, for all of these impaired securities indicates that it is now probable we will collect principal and interest in excess of what was estimated at the time other-than-temporary impairment charges were recorded. This change can be attributed to improvement in the underlying collateral for these securities and has resulted in the present value of estimated future principal and interest payments exceeding the securities' current book value. The excess for each bond of the present value of future cash flows over our current book value ranges from 19% to 123% and will be recognized as an adjustment to yield over the remaining life of these securities. The excess subordination recognized as an adjustment to yield is reflected in the following table as increases in cash flows expected to be collected.

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The following table provides a cumulative roll forward of credit losses recognized in earnings for debt securities held and not intended to be sold:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
	(dollars in thousands)			
Balance, beginning (a)	$24,310	$25,366	$24,851	$26,246
Credit losses on debt securities for which other-than-temporary impairment was not previously recognized	—	—	—	—
Additional credit losses on debt securities for which other-than-temporary impairment was previously recognized	—	—	—	—
Increases in cash flows expected to be collected, recognized over the remaining life of the security (b)	(270)	(255)	(811)	(917)
Reduction for debt securities called during the period	—	—	—	(218)
Balance, ending	$24,040	$25,111	$24,040	$25,111

(a) The beginning balance represents credit related losses included in other-than-temporary impairment charges recognized on debt securities in prior periods.
(b) Represents the increase in cash flows recognized in interest income during the period.

In the first nine months of 2016 and 2015, no other-than-temporary impairment charges were recorded on equity securities. On a quarterly basis, management evaluates equity securities for other-than-temporary impairment by reviewing the severity and duration of decline in estimated fair value, research reports, analysts' recommendations, credit rating changes, news stories, annual reports, regulatory filings, impact of interest rate changes and other relevant information. As of September 30, 2016 and 2015, there were no equity securities in an unrealized loss position.

Other Investments

As a member of the Federal Home Loan Bank ("FHLB"), First Commonwealth is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. The level of stock required to be held is dependent on the amount of First Commonwealth's mortgage-related assets and outstanding borrowings with the FHLB. This stock is restricted in that it can only be sold to the FHLB or to another member institution, and all sales of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants. As of September 30, 2016 and December 31, 2015, our FHLB stock totaled $54.1 million and $63.0 million, respectively, and is included in "Other investments" on the Condensed Consolidated Statements of Financial Condition.

FHLB stock is held as a long-term investment and its value is determined based on the ultimate recoverability of the par value. First Commonwealth evaluates impairment quarterly and has concluded that the par value of its investment in FHLB stock will be recovered. Accordingly, no impairment charge was recorded on these securities during the three and nine months ended September 30, 2016.

Note 8 Loans and Allowance for Credit Losses

The following table provides outstanding balances related to each of our loan types:

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Commercial, financial, agricultural and other	$1,207,447	$1,150,906

Real estate construction	229,375	220,736
Residential real estate	1,185,759	1,224,465
Commercial real estate	1,683,015	1,479,000
Loans to individuals	555,056	608,643
Total loans	$4,860,652	$4,683,750

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Credit Quality Information

As part of the on-going monitoring of credit quality within the loan portfolio, the following credit worthiness categories are used in grading our loans:

Pass	Acceptable levels of risk exist in the relationship. Includes all loans not classified as OAEM, substandard or doubtful.
Other Assets Especially Mentioned (OAEM)	Potential weaknesses that deserve management's close attention. The potential weaknesses may result in deterioration of the repayment prospects or weaken the Company's credit position at some future date. The credit risk may be relatively minor, yet constitute an undesirable risk in light of the circumstances surrounding the specific credit. No loss of principal or interest is expected.
Substandard	Well-defined weakness or a weakness that jeopardizes the repayment of the debt. A loan may be classified as substandard as a result of deterioration of the borrower's financial condition and repayment capacity. Loans for which repayment plans have not been met or collateral equity margins do not protect the Company may also be classified as substandard.
Doubtful	Loans with the characteristics of substandard loans with the added characteristic that collection or liquidation in full, on the basis of presently existing facts and conditions, is highly improbable.

The use of creditworthiness categories to grade loans permits management's use of migration analysis to estimate a portion of credit risk. The Company's internal creditworthiness grading system provides a measurement of credit risk based primarily on an evaluation of the borrower's cash flow and collateral. Movement between these rating categories provides a predictive measure of credit losses and therefore assists in determining the appropriate level for the loan loss reserves. Category ratings are reviewed each quarter, at which time management analyzes the results, as well as other external statistics and factors related to loan performance. Loans that migrate towards higher risk rating levels generally have an increased risk of default, whereas loans that migrate toward lower risk ratings generally will result in a lower risk factor being applied to those related loan balances.

The following tables represent our credit risk profile by creditworthiness:

	September 30, 2016					
	Commercial, financial, agricultural and other	Real estate construction	Residential real estate	Commercial real estate	Loans to individuals	Total
	(dollars in thousands)					
Pass	$1,105,422	$ 229,092	$1,172,174	$1,661,908	$ 554,792	$4,723,388
Non-Pass						
OAEM	26,758	283	5,962	7,002	—	40,005
Substandard	75,267	—	7,623	14,105	264	97,259
Doubtful	—	—	—	—	—	—
Total Non-Pass	102,025	283	13,585	21,107	264	137,264
Total	$1,207,447	$ 229,375	$1,185,759	$1,683,015	$ 555,056	$4,860,652

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	December 31, 2015					
	Commercial, financial, agricultural and other	Real estate construction	Residential real estate	Commercial real estate	Loans to individuals	Total
	(dollars in thousands)					
Pass	$1,074,858	$ 220,267	$1,209,606	$1,436,714	$ 608,342	$4,549,787
Non-Pass						
OAEM	11,825	442	5,244	30,012	—	47,523
Substandard	64,223	27	9,615	12,274	301	86,440
Doubtful	—	—	—	—	—	—
Total Non-Pass	76,048	469	14,859	42,286	301	133,963
Total	$1,150,906	$ 220,736	$1,224,465	$1,479,000	$ 608,643	$4,683,750

Portfolio Risks

The credit quality of our loan portfolio can potentially represent significant risk to our earnings, capital, regulatory agency relationships, investment community reputation and shareholder returns. First Commonwealth devotes a substantial amount of resources managing this risk primarily through our credit administration department that develops and administers policies and procedures for underwriting, maintaining, monitoring and collecting activities. Credit administration is independent of lending departments and oversight is provided by the credit committee of the First Commonwealth Board of Directors.

Criticized loans have been evaluated when determining the appropriateness of the allowance for credit losses, which we believe is adequate to absorb losses inherent to the portfolio as of September 30, 2016. However, changes in economic conditions, interest rates, borrower financial condition, delinquency trends or previously established fair values of collateral factors could significantly change those judgmental estimates.

Age Analysis of Past Due Loans by Segment

The following tables delineate the aging analysis of the recorded investments in past due loans as of September 30, 2016 and December 31, 2015. Also included in these tables are loans that are 90 days or more past due and still accruing because they are well-secured and in the process of collection.

	September 30, 2016						
	30 - 59 days past due	60 - 89 days past due	90 days and greater and still accruing	Nonaccrual	Total past due and nonaccrual	Current	Total
	(dollars in thousands)						
Commercial, financial, agricultural and other	$780	$37	$ 826	$ 30,868	$ 32,511	$1,174,936	$1,207,447
Real estate construction	—	—	—	—	—	229,375	229,375
Residential real estate	3,736	878	527	6,031	11,172	1,174,587	1,185,759
Commercial real estate	785	73	195	3,377	4,430	1,678,585	1,683,015
Loans to individuals	2,038	615	795	264	3,712	551,344	555,056
Total	$7,339	$1,603	$ 2,343	$ 40,540	$ 51,825	$4,808,827	$4,860,652

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	December 31, 2015						
	30 - 59 days past due	60 - 89 days past due	90 days and greater and still accruing	Nonaccrual	Total past due and nonaccrual	Current	Total
	(dollars in thousands)						
Commercial, financial, agricultural and other	$364	$49	$ 129	$ 23,653	$ 24,195	$1,126,711	$1,150,906
Real estate construction	280	—	—	28	308	220,428	220,736
Residential real estate	4,175	1,055	1,315	6,500	13,045	1,211,420	1,224,465
Commercial real estate	781	—	65	6,223	7,069	1,471,931	1,479,000
Loans to individuals	2,998	774	946	301	5,019	603,624	608,643
Total	$8,598	$1,878	$ 2,455	$ 36,705	$ 49,636	$4,634,114	$4,683,750

Nonaccrual Loans

The previous tables summarize nonaccrual loans by loan segment. The Company generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, when part of the principal balance has been charged off and no restructuring has occurred, or the loans reach a certain number of days past due. Generally, loans 90 days or more past due are placed on nonaccrual status, except for consumer loans, which are placed in nonaccrual status at 150 days past due.

When a loan is placed on nonaccrual, the accrued unpaid interest receivable is reversed against interest income and all future payments received are applied as a reduction to the loan principal. Generally, the loan is returned to accrual status when (a) all delinquent interest and principal becomes current under the terms of the loan agreement or (b) the loan is both well-secured and in the process of collection and collectability is no longer in doubt.

Impaired Loans

Management considers loans to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all loan categories. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan’s effective interest rate, except when the sole source for repayment of the loan is the operation or liquidation of collateral. When the loan is collateral dependent, the appraised value less estimated cost to sell is utilized. If management determines the value of the impaired loan is less than the recorded investment in the loan, impairment is recognized through an allowance estimate or a charge-off to the allowance. Troubled debt restructured loans on accrual status are also considered to be impaired loans.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received under the cash basis method.

Significant nonaccrual loans as of September 30, 2016, include the following:

- An $11.8 million relationship of commercial industrial loans to a steel and aluminum servicing company. These loans were originated in 2011 and were placed in nonaccrual status during the first quarter of 2016. The collateral valuation completed in the third quarter of 2016 incorporated certain estimates obtained in the first quarter of 2016.
- A $4.3 million relationship of commercial industrial loans to an oil and gas well services company. These loans were originated in 2014 and were placed in nonaccrual status during the fourth quarter of 2015. During the nine months ended September 30, 2016, charge-offs of $2.0 million related to this relationship were recorded. Values used in the September 30, 2016 collateral valuation were updated in the third quarter of 2016.

- A $4.0 million relationship of commercial industrial loans to a manufacturer of mine safety products. These loans were originated from 2014 to 2015 and were placed in nonaccrual status during the second quarter of 2016. During the nine months ended September 30, 2016, charge-offs of $6.5 million related to this relationship were recorded. A collateral valuation completed in September 2016 incorporated certain estimates obtained in the second quarter of 2016.

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- A $3.4 million relationship of commercial industrial loans to a local energy company involved in the drilling and production of natural gas wells. These loans were originated from 2008 to 2011 and were placed in nonaccrual status during the third quarter of 2013. Two of these loans were modified resulting in TDR classification: one loan totaling $1.0 million was modified in 2012, and the other loan totaling $2.3 million was modified in 2014. During the nine months ended September 30, 2016, charge-offs of $1.3 million related to this relationship were recorded. The September 30, 2016 collateral valuation incorporated estimates obtained in the first quarter of 2016.
- A $3.3 million relationship of commercial industrial loans to a gear manufacturer. These loans were originated in 2013 and were placed in nonaccrual status during the third quarter of 2015. During the nine months ended September 30, 2016, charge-offs of $0.4 million related to this relationship were recorded. The September 30, 2016 collateral valuation incorporated estimates obtained in the second quarter of 2016.

The following tables include the recorded investment and unpaid principal balance for impaired loans with the associated allowance amount, if applicable, as of September 30, 2016 and December 31, 2015. Also presented are the average recorded investment in impaired loans and the related amount of interest recognized while the loan was considered impaired. Average balances are calculated using month-end balances of the loans for the period reported and are included in the table below based on their period-end allowance position.

	September 30, 2016			December 31, 2015		
	Recorded investment	Unpaid principal balance	Related allowance	Recorded investment	Unpaid principal balance	Related allowance
	(dollars in thousands)					
With no related allowance recorded:						
Commercial, financial, agricultural and other	$17,948	$27,205		$11,344	$15,673	
Real estate construction	—	—		28	117	
Residential real estate	11,506	13,513		9,952	11,819	
Commercial real estate	6,045	7,244		7,562	9,449	
Loans to individuals	377	444		421	507	
Subtotal	35,876	48,406		29,307	37,565	
With an allowance recorded:						
Commercial, financial, agricultural and other	18,238	20,748	7,739	20,132	22,590	6,952
Real estate construction	—	—	—	—	—	—
Residential real estate	175	215	6	461	672	51
Commercial real estate	537	537	430	944	1,008	42
Loans to individuals	—	—	—	—	—	—
Subtotal	18,950	21,500	8,175	21,537	24,270	7,045
Total	$54,826	$69,906	$ 8,175	$50,844	$61,835	$ 7,045

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	For the Nine Months Ended September 30,			
	2016		2015	
	Average recorded investment	Interest Income Recognized	Average recorded investment	Interest Income Recognized
	(dollars in thousands)			
With no related allowance recorded:				
Commercial, financial, agricultural and other	$24,020	$ 421	$19,199	$ 161
Real estate construction	6	44	102	—
Residential real estate	11,546	232	10,987	118
Commercial real estate	7,143	140	8,545	69
Loans to individuals	423	10	312	14
Subtotal	43,138	847	39,145	362
With an allowance recorded:				
Commercial, financial, agricultural and other	15,310	77	6,125	100
Real estate construction	—	—	—	—
Residential real estate	111	—	275	—
Commercial real estate	524	18	83	4
Loans to individuals	—	—	—	—
Subtotal	15,945	95	6,483	104
Total	$59,083	$ 942	$45,628	$ 466

	For the Three Months Ended September 30,			
	2016		2015	
	Average recorded investment	Interest Income Recognized	Average recorded investment	Interest Income Recognized
	(dollars in thousands)			
With no related allowance recorded:				
Commercial, financial, agricultural and other	$24,674	$ 128	$14,215	$ 40
Real estate construction	—	—	32	—
Residential real estate	11,636	94	10,748	39
Commercial real estate	6,463	73	7,894	26
Loans to individuals	384	7	314	5
Subtotal	43,157	302	33,203	110
With an allowance recorded:				
Commercial, financial, agricultural and other	17,207	22	7,700	29
Real estate construction	—	—	—	—
Residential real estate	174	—	351	—
Commercial real estate	547	7	81	1
Loans to individuals	—	—	—	—
Subtotal	17,928	29	8,132	30
Total	$61,085	$ 331	$41,335	$ 140

Unfunded commitments related to nonperforming loans were $0.4 million at September 30, 2016 and $0.1 million at December 31, 2015. After consideration of the requirements to draw and available collateral related to these commitments, a reserve of $12 thousand and $13 thousand was established for these off balance sheet exposures at September 30, 2016 and December 31, 2015, respectively.

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Troubled debt restructured loans are those loans whose terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of the financial difficulties experienced by the borrower, who could not obtain comparable terms from alternate financing sources.

The following table provides detail as to the total troubled debt restructured loans and total commitments outstanding on troubled debt restructured loans:

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Troubled debt restructured loans		
Accrual status	$14,286	$ 14,139
Nonaccrual status	12,723	12,360
Total	$27,009	$ 26,499
Commitments		
Unused lines of credit	$349	$ 3,252

The following tables provide detail, including specific reserves and reasons for modification, related to loans identified as troubled debt restructurings:

	For the Nine Months Ended September 30, 2016						
		Type of Modification					
	Number of Contracts	Extend Maturity	Modify Rate	Modify Payments	Total Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserve
	(dollars in thousands)						
Commercial, financial, agricultural and other	5	$93	$4,009	$ 3,853	$ 7,955	$ 7,281	$ 1,612
Residential real estate	35	—	214	2,548	2,762	2,620	—
Commercial real estate	7	1,348	—	25	1,373	1,285	68
Loans to individuals	10	—	71	25	96	76	—
Total	57	$1,441	$4,294	$ 6,451	$ 12,186	$ 11,262	$ 1,680

	For the Nine Months Ended September 30, 2015						
		Type of Modification					
	Number of Contracts	Extend Maturity	Modify Rate	Modify Payments	Total Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserve
	(dollars in thousands)						
Commercial, financial, agricultural and other	4	$1,751	$ —	$ 652	$ 2,403	$ 2,314	$ 52
Residential real estate	24	—	296	958	1,254	1,165	—
Commercial real estate	1	—	—	464	464	407	—
Loans to individuals	8	—	61	35	96	77	—
Total	37	$1,751	$ 357	$ 2,109	$ 4,217	$ 3,963	$ 52

The troubled debt restructurings included in the above tables are also included in the impaired loan tables provided earlier in this note. Loans defined as modified due to a change in rate may include loans that were modified for a change in rate as well as a re-amortization of the principal and an extension of the maturity. For the nine months ended September 30, 2016 and 2015, $4.3 million and $0.4 million, respectively, of total rate modifications represent loans with modifications to the rate as well as payment as a result of re-amortization. For both 2016 and 2015 the changes in loan balances between the pre-modification balance and the post-modification balance are due to customer payments.

The following tables provide detail, including specific reserves and reasons for modification, related to loans identified as troubled debt restructurings:

	For the Three Months Ended September 30, 2016						
		Type of Modification					
	Number of Contracts	Extend Maturity	Modify Rate	Modify Payments	Total Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserve
	(dollars in thousands)						
Commercial, financial, agricultural and other	1	$ —	$ —	$ 3,853	$ 3,853	$ 3,853	$ 1,612
Residential real estate	11	—	100	373	473	441	—
Commercial real estate	1	85	—	—	85	85	—
Loans to individuals	4	—	42	10	52	45	—
Total	17	$ 85	$ 142	$ 4,236	$ 4,463	$ 4,424	$ 1,612

	For the Three Months Ended, September 30, 2015						
		Type of Modification					
	Number of Contracts	Extend Maturity	Modify Rate	Modify Payments	Total Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserve
	(dollars in thousands)						
Commercial, financial, agricultural and other	1	$ —	$ —	$ 543	$ 543	$ 525	$ —
Residential real estate	8	—	—	455	455	455	—
Loans to individuals	2	—	—	18	18	16	—
Total	11	$ —	$ —	$ 1,016	$ 1,016	$ 996	$ —

The troubled debt restructurings included in the above tables are also included in the impaired loan tables provided earlier in this note. Loans defined as modified due to a change in rate may include loans that were modified for a change in rate as well as a re-amortization of the principal and an extension of the maturity. For the three months ended September 30, 2016, $0.1 million of total rate modifications represent loans with modifications to the rate as well as payment as a result of re-amortization. None of the rate modifications for three months ended September 30, 2015 represent loans with modifications to the rate as well as the payment. For both 2016 and 2015 the changes in loan balances between the pre-modification balance and the post-modification balance are due to customer payments.

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A troubled debt restructuring is considered to be in default when a restructured loan is 90 days or more past due. The following table provides information related to restructured loans that were considered to be in default during the nine months ended September 30:

	2016		2015	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(dollars in thousands)			
Residential real estate	—	$ —	3	$ 108
Total	—	$ —	3	$ 108

The following table provides information related to restructured loans that were considered to be in default during the three months ended September 30:

	2016		2015	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(dollars in thousands)			
Residential real estate	—	$ —	2	$ 105
Total	—	$ —	2	$ 105

The following tables provide detail related to the allowance for credit losses:

	For the Nine Months Ended September 30, 2016					
	Commercial, financial, agricultural and other	Real estate construction	Residential real estate	Commercial real estate	Loans to individuals	Total
	(dollars in thousands)					
Allowance for credit losses:						
Beginning Balance	$ 31,035	$ 887	$ 2,606	$ 11,924	$ 4,360	$ 50,812
Charge-offs	(13,308)	—	(976)	(418)	(3,751)	(18,453)
Recoveries	261	227	407	803	371	2,069
Provision (credit)	23,935	(638)	330	(6,725)	3,404	20,306
Ending Balance	$ 41,923	$ 476	$ 2,367	$ 5,584	$ 4,384	$ 54,734
Ending balance: individually evaluated for impairment	$ 7,739	$ —	$ 6	$ 430	$ —	$ 8,175
Ending balance: collectively evaluated for impairment	34,184	476	2,361	5,154	4,384	46,559
Loans:						
Ending balance	1,207,447	229,375	1,185,759	1,683,015	555,056	4,860,652
Ending balance: individually evaluated for impairment	35,501	—	5,670	5,081	—	46,252
Ending balance: collectively evaluated for impairment	1,171,946	229,375	1,180,089	1,677,934	555,056	4,814,400

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	For the Nine Months Ended September 30, 2015					
	Commercial, financial, agricultural and other	Real estate construction	Residential real estate	Commercial real estate	Loans to individuals	Total
	(dollars in thousands)					
Allowance for credit losses:						
Beginning Balance	$29,627	$ 2,063	$ 3,664	$ 11,881	$ 4,816	$52,051
Charge-offs	(8,579)	—	(1,351)	(1,249)	(3,283)	(14,462)
Recoveries	922	84	417	186	502	2,111
Provision (credit)	5,230	(554)	(54)	1,584	2,612	8,818
Ending Balance	$27,200	$ 1,593	$ 2,676	$ 12,402	$ 4,647	$48,518
Ending balance: individually evaluated for impairment	$4,202	$ —	$ 20	$ 33	$ —	$4,255
Ending balance: collectively evaluated for impairment	22,998	1,593	2,656	12,369	4,647	44,263
Loans:						
Ending balance	1,126,881	179,710	1,204,220	1,435,954	628,970	4,575,735
Ending balance: individually evaluated for impairment	22,852	—	6,037	5,706	—	34,595
Ending balance: collectively evaluated for impairment	1,104,029	179,710	1,198,183	1,430,248	628,970	4,541,140

	For the Three Months Ended September 30, 2016					
	Commercial, financial, agricultural and other	Real estate construction	Residential real estate	Commercial real estate	Loans to individuals	Total
	(dollars in thousands)					
Allowance for credit losses:						
Beginning Balance	$46,357	$ 480	$ 2,605	$ 5,862	$ 4,517	$59,821
Charge-offs	(7,163)	—	(374)	(10)	(1,260)	(8,807)
Recoveries	63	—	147	20	82	312
Provision (credit)	2,666	(4)	(11)	(288)	1,045	3,408
Ending Balance	$41,923	$ 476	$ 2,367	$ 5,584	$ 4,384	$54,734

	For the Three Months Ended, September 30, 2015					
	Commercial, financial, agricultural and other	Real estate construction	Residential real estate	Commercial real estate	Loans to individuals	Total
	(dollars in thousands)					
Allowance for credit losses:						
Beginning Balance	$23,755	$ 1,518	$ 2,923	$ 12,227	$ 4,921	$45,344
Charge-offs	(639)	—	(301)	(561)	(900)	(2,401)
Recoveries	564	—	178	33	179	954
Provision (credit)	3,520	75	(124)	703	447	4,621
Ending Balance	$27,200	$ 1,593	$ 2,676	$ 12,402	$ 4,647	$48,518

Note 9 Income Taxes

At September 30, 2016 and December 31, 2015, First Commonwealth had no material unrecognized tax benefits or accrued interest and penalties. If applicable, First Commonwealth will record interest and penalties as a component of noninterest expense. Federal and state tax years 2013 through 2015 are open for examination as of September 30, 2016.

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Note 10 Fair Values of Assets and Liabilities

FASB ASC Topic 820, "Fair Value Measurements and Disclosures," requires disclosures for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). All non-financial assets are included either as a separate line item on the Condensed Consolidated Statements of Financial Condition or in the "Other assets" category of the Condensed Consolidated Statements of Financial Condition. Currently, First Commonwealth does not have any non-financial liabilities to disclose.

FASB ASC Topic 825, "Financial Instruments", permits entities to irrevocably elect to measure select financial instruments and certain other items at fair value. The unrealized gains and losses are required to be included in earnings each reporting period for the items that fair value measurement is elected. First Commonwealth has elected not to measure any existing financial instruments at fair value under FASB ASC Topic 825; however, in the future we may elect to adopt this guidance for select financial instruments.

In accordance with FASB ASC Topic 820, First Commonwealth groups financial assets and financial liabilities measured at fair value in three levels based on the principal markets in which the assets and liabilities are transacted and the observability of the data points used to determine fair value. These levels are:

- Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange ("NYSE"). Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained for identical or comparable assets or liabilities from alternative pricing sources with reasonable levels of price transparency. Level 2 includes Obligations of U.S. Government securities issued by Agencies and Sponsored Enterprises, Obligations of States and Political Subdivisions, corporate securities, FHLB stock, loans held for sale, interest rate derivatives (including interest rate caps, interest rate swaps and risk participation agreements), certain other real estate owned and certain impaired loans.

Level 2 investment securities are valued by a recognized third party pricing service using observable inputs. The model used by the pricing service varies by asset class and incorporates available market, trade and bid information as well as cash flow information when applicable. Because many fixed-income investment securities do not trade on a daily basis, the model uses available information such as benchmark yield curves, benchmarking of like investment securities, sector groupings and matrix pricing. The model will also use processes such as an option adjusted spread to assess the impact of interest rates and to develop prepayment estimates. Market inputs normally used in the pricing model include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data including market research publications.

Management validates the market values provided by the third party service by having another recognized pricing service price 100% of the securities on an annual basis and a random sample of securities each quarter, monthly monitoring of variances from prior period pricing and, on a monthly basis, evaluating pricing changes compared to expectations based on changes in the financial markets.

Other investments recorded in the Condensed Consolidated Statements of Financial Condition are comprised of FHLB stock whose estimated fair value is based on its par value. Additional information on FHLB stock is provided in Note 7, "Impairment of Investment Securities."

Loans held for sale include residential mortgage loans originated for sale in the secondary mortgage market. The estimated fair value for these loans was determined on the basis of rates obtained in the respective secondary market.

Interest rate derivatives are reported at an estimated fair value utilizing Level 2 inputs and are included in other assets and other liabilities, and consist of interest rate swaps where there is no significant deterioration in the counterparties' (loan customers') credit risk since origination of the interest rate swap as well as interest rate caps and risk participation agreements. First Commonwealth values its interest rate swap and cap positions using a yield curve by taking market prices/rates for an appropriate set of instruments. The set of instruments currently used to determine the U.S. Dollar yield curve includes cash LIBOR rates from overnight to one year, Eurodollar futures contracts and swap rates from one year to thirty years. These yield curves determine the valuations of interest rate swaps. Interest rate derivatives are further described in Note 11, “Derivatives.”

For purposes of potential valuation adjustments to our derivative positions, First Commonwealth evaluates the credit risk of its counterparties as well as our own credit risk. Accordingly, we have considered factors such as the likelihood of default, expected loss given default, net exposures and remaining contractual life, among other things, in determining if any fair value adjustments related to credit risk are required. We review our counterparty exposure quarterly, and when necessary, appropriate adjustments are made to reflect the exposure.

We also utilize this approach to estimate our own credit risk on derivative liability positions. In 2016, we have not realized any losses due to a counterparty's inability to pay any uncollateralized positions.

The estimated fair value for other real estate owned included in Level 2 is determined by either an independent market-based appraisal less estimated costs to sell or an executed sales agreement.

- Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer or broker traded transactions. If the inputs used to provide the valuation are unobservable and/or there is very little, if any, market activity for the security or similar securities, the securities would be considered Level 3 securities. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities. The assets included in Level 3 are pooled trust preferred collateralized debt obligations, non-marketable equity investments, certain interest rate derivatives, certain other real estate owned and certain impaired loans.

Our pooled trust preferred collateralized debt obligations are collateralized by the trust preferred securities of individual banks, thrifts and bank holding companies in the United States. There has been little or no active trading in these securities since 2009; therefore, it is more appropriate to determine estimated fair value using a discounted cash flow analysis. Detail on our process for determining the appropriate cash flows for this analysis is provided in Note 7, “Impairment of Investment Securities.” The discount rate applied to the cash flows is determined by evaluating the current market yields for comparable corporate and structured credit products along with an evaluation of the risks associated with the cash flows of the comparable security. Due to the fact that there is no active market for the pooled trust preferred collateralized debt obligations, one key reference point is the market yield for the single issue trust preferred securities issued by banks and thrifts for which there is more activity than for the pooled securities. Adjustments are then made to reflect the credit and structural differences between these two security types.

Management validates the fair value of the pooled trust preferred collateralized debt obligations by monitoring the performance of the underlying collateral, discussing the discount rate, cash flow assumptions and general market trends with a specialized third party and confirming changes in the underlying collateral to the trustee reports. Management’s monitoring of the underlying collateral includes deferrals of interest payments, payment defaults, cures of previously deferred interest payments, any regulatory filings or actions and general news related to the underlying collateral. Management also evaluates fair value changes compared to expectations based on changes in the interest rates used in determining the discount rate and general financial markets.

The estimated fair value of the non-marketable equity investments included in Level 3 is based on par value.

The estimated fair value of limited partnership investments included in Level 3 is based on par value.

For interest rate derivatives included in Level 3, the fair value incorporates credit risk by considering such factors as likelihood of default and expected loss given default based on the credit quality of the underlying counterparties (loan customers).

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In accordance with ASU 2011-4, the following table provides information related to quantitative inputs and assumptions used in Level 3 fair value measurements.

	Fair Value (dollars in thousands)		Valuation Technique	Unobservable Inputs	Range / (weighted average)
Pooled Trust Preferred Securities	$ 35,609		Discounted Cash Flow	Probability of default	0% - 100% (10.26%)
				Prepayment rates	0% - 72.91% (4.00%)
				Discount rates	5.25% - 12.00% (a)
Equities	1,670		Par Value	N/A	N/A
Impaired Loans	2,348	(b)	Reserve study	Discount rate	10.00%
				Gas per MCF	$1.63 - $3.38 (c)
				Oil per BBL/d	$40.97 - $56.16 (c)
	7,308	(b)	Discounted Cash Flow	Discount Rate	1.90% - 4.68%
Limited Partnership Investments	704		Par Value	N/A	N/A

(a) Incorporates spread over risk free rate related primarily to credit quality and illiquidity of securities.
(b) The remainder of impaired loans valued using Level 3 inputs are not included in this disclosure as the values of those loans are based on bankruptcy agreement documentation.
(c) Unobservable inputs are defined as follows: MCF - million cubic feet; BBL/d - barrels per day.

The significant unobservable inputs used in the fair value measurement of pooled trust preferred securities are the probability of default, discount rates and prepayment rates. Significant increases in the probability of default or discount rate used would result in a decrease in the estimated fair value of these securities, while decreases in these variables would result in higher fair value measurements. In general, a change in the assumption of probability of default is accompanied by a directionally similar change in the discount rate. In most cases, increases in the prepayment rate assumptions would result in a higher estimated fair value for these securities while decreases would provide for a lower value. The direction of this change is somewhat dependent on the structure of the investment and the amount of the investment tranches senior to our position.

The discount rate is the significant unobservable input used in the fair value measurement of impaired loans. Significant increases in this rate would result in a decrease in the estimated fair value of the loans, while a decrease in this rate would result in a higher fair value measurement. Other unobservable inputs in the fair value measurement of impaired loans relate to gas, oil and natural gas prices. Increases in these prices would result in an increase in the estimated fair value of the loans, while a decrease in these prices would result in a lower fair value measurement.

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis:

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Obligations of U.S. Government Agencies:				
Mortgage-Backed Securities - Residential	$—	$17,976	$—	$17,976
Obligations of U.S. Government-Sponsored Enterprises:				
Mortgage-Backed Securities - Residential	—	704,626	—	704,626
Mortgage-Backed Securities - Commercial	—	1	—	1
Other Government-Sponsored Enterprises	—	19,307	—	19,307
Obligations of States and Political Subdivisions	—	27,951	—	27,951
Corporate Securities	—	6,519	—	6,519
Pooled Trust Preferred Collateralized Debt Obligations	—	—	35,609	35,609
Total Debt Securities	—	776,380	35,609	811,989
Equities	—	—	1,670	1,670
Total Securities Available for Sale	—	776,380	37,279	813,659
Other Investments	—	54,066	—	54,066
Loans held for sale	—	7,855	—	7,855
Other Assets(a)	—	19,224	704	19,928
Total Assets	$—	$857,525	$37,983	$895,508
Other Liabilities(a)	$—	$18,879	$—	$18,879
Total Liabilities	$—	$18,879	$—	$18,879

(a) Hedging and non-hedging interest rate derivatives

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Obligations of U.S. Government Agencies:				
Mortgage-Backed Securities - Residential	$—	$22,092	$—	$22,092
Obligations of U.S. Government-Sponsored Enterprises:				
Mortgage-Backed Securities - Residential	—	777,577	—	777,577
Mortgage-Backed Securities - Commercial	—	28	—	28
Other Government-Sponsored Enterprises	—	19,118	—	19,118
Obligations of States and Political Subdivisions	—	27,598	—	27,598
Corporate Securities	—	2,319	—	2,319
Pooled Trust Preferred Collateralized Debt Obligations	—	—	35,658	35,658
Total Debt Securities	—	848,732	35,658	884,390
Equities	—	—	2,170	2,170
Total Securities Available for Sale	—	848,732	37,828	886,560
Other Investments	—	62,952	—	62,952
Loans held for sale	—	5,763	—	5,763
Other Assets(a)	—	11,273	—	11,273
Total Assets	$—	$928,720	$37,828	$966,548
Other Liabilities(a)	$—	$10,829	$—	$10,829
Total Liabilities	$—	$10,829	$—	$10,829

(a) Hedging and non-hedging interest rate derivatives

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the nine months ended September 30, changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	2016			
	Pooled Trust Preferred Collateralized Debt Obligations	Equities	Other Assets	Total
	(dollars in thousands)			
Balance, beginning of period	$35,658	$2,170	$ —	$37,828
Total gains or losses				
Included in earnings	—	—	—	—
Included in other comprehensive income	(19)	—	—	(19)
Purchases, issuances, sales and settlements				
Purchases	—	36	168	204
Issuances	—	—	—	—
Sales	—	—	—	—
Settlements	(30)	—	—	(30)
Transfers from Level 3	—	(536)	—	(536)
Transfers into Level 3	—	—	536	536
Balance, end of period	$35,609	$1,670	$ 704	$37,983

	2015		
	Pooled Trust Preferred Collateralized Debt Obligations	Equities	Total
	(dollars in thousands)		
Balance, beginning of period	$28,999	$ 1,420	$30,419
Total gains or losses			
Included in earnings	105	—	105
Included in other comprehensive income	7,729	—	7,729
Purchases, issuances, sales and settlements			
Purchases	—	500	500
Issuances	—	—	—
Sales	—	—	—
Settlements	(1,054)	—	(1,054)
Transfers into Level 3	—	—	—
Balance, end of period	$35,779	$ 1,920	$37,699

During the nine months ended September 30, 2016, $0.5 million in investments in limited partnerships were moved from other equity securities to other assets constituting the transfers into and out of Level 3. During the nine months ended September 30, 2015, there were no transfers between fair value Levels 1, 2 or 3. There were no gains or losses included in earnings for the periods presented that are attributable to the change in realized gains (losses) relating to assets held at September 30, 2016 and 2015.

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the three months ended September 30, changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	2016			
	Pooled Trust Preferred Collateralized Debt Obligations	Equities	Other Assets	Total
	(dollars in thousands)			
Balance, beginning of period	$33,723	$1,670	$704	$36,097
Total gains or losses				
Included in earnings	—	—	—	—
Included in other comprehensive income	1,886	—	—	1,886
Purchases, issuances, sales and settlements				
Purchases	—	—	—	—
Issuances	—	—	—	—
Sales	—	—	—	—
Settlements	—	—	—	—
Transfers from Level 3	—	—	—	—
Transfers into Level 3	—	—	—	—
Balance, end of period	$35,609	$1,670	$704	$37,983

	2015		
	Pooled Trust Preferred Collateralized Debt Obligations	Equities	Total
	(dollars in thousands)		
Balance, beginning of period	$35,521	$1,920	37,441
Total gains or losses			
Included in earnings	—	—	—
Included in other comprehensive income	258	—	258
Purchases, issuances, sales and settlements			
Purchases	—	—	—
Issuances	—	—	—
Sales	—	—	—
Settlements	—	—	—
Transfers into Level 3	—	—	—
Balance, end of period	$35,779	$1,920	$37,699

During the three months ended September 30, 2016 and 2015, there were no transfers between fair value Levels 1, 2 or 3. There were no gains or losses included in earnings for the periods presented that are attributable to the change in realized gains (losses) relating to assets held at September 30, 2016 and 2015.

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The tables below present the balances of assets measured at fair value on a nonrecurring basis at:

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Impaired loans	$—	$28,158	$18,493	$46,651
Other real estate owned	—	8,620	—	8,620
Total Assets	$—	$36,778	$18,493	$55,271

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Impaired loans	$—	$30,979	$12,820	$43,799
Other real estate owned	—	10,039	8	10,047
Total Assets	$—	$41,018	$12,828	$53,846

The following gain (losses) were realized on the assets measured on a nonrecurring basis:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
	(dollars in thousands)			
Impaired loans	$386	$(2,838)	$(13,982)	$(3,532)
Other real estate owned	(114)	(78)	(331)	(1,205)
Total losses	$272	$(2,916)	$(14,313)	$(4,737)

Impaired loans over $100 thousand are individually reviewed to determine the amount of each loan considered to be at risk of non-collection. The fair value for impaired loans that are collateral based is determined by reviewing real property appraisals, equipment valuations, accounts receivable listings and other financial information. A discounted cash flow analysis is performed to determine fair value for impaired loans when an observable market price or a current appraisal is not available. For real estate secured loans, First Commonwealth's loan policy requires updated appraisals be obtained at least every twelve months on all impaired loans with balances of $250 thousand and over. For real estate secured loans with balances under $250 thousand, we rely on broker price opinions. For non-real estate secured assets, the Company normally relies on third party valuations specific to the collateral type.

The fair value for other real estate owned, determined by either an independent market-based appraisal less estimated costs to sell or an executed sales agreement, is classified as Level 2. The fair value for other real estate owned determined using an internal valuation is classified as Level 3. Other real estate owned has a current carrying value of $7.7 million as of September 30, 2016 and consists primarily of commercial real estate properties in Pennsylvania. We review whether events and circumstances subsequent to a transfer to other real estate owned have occurred that indicate the balance of those assets may not be recoverable. If events and circumstances indicate further impairment we will record a charge to the extent that the carrying value of the assets exceed their fair values, less estimated cost to sell, as determined by valuation techniques appropriate in the circumstances.

Certain other assets and liabilities, including goodwill and core deposit intangibles, are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments only in certain circumstances. Additional information related to goodwill is provided in Note 12, "Goodwill." There were no other assets or liabilities measured at fair value on a nonrecurring basis during the nine months ended September 30, 2016.

FASB ASC 825-10, "Transition Related to FSP FAS 107-1" and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments," requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are as discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

Cash and due from banks and interest-bearing bank deposits: The carrying amounts for cash and due from banks and interest-bearing bank deposits approximate the estimated fair values of such assets.

Securities: Fair values for securities available for sale and held to maturity are based on quoted market prices, if available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. Pooled trust preferred collateralized debt obligations values are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer or broker traded transactions. These valuations incorporate certain assumptions and projections in determining the fair value assigned to each instrument. The carrying value of other investments, which includes FHLB stock, is considered a reasonable estimate of fair value.

Loans: The fair values of all loans are estimated by discounting the estimated future cash flows using interest rates currently offered for loans with similar terms to borrowers of similar credit quality adjusted for past due and nonperforming loans, which is not an exit price under FASB ASC Topic 820, “Fair Value Measurements and Disclosures.”

Loans Held for Sale: The estimated fair value of loans held for sale is based on market bids obtained from potential buyers.

Off-balance sheet instruments: Many of First Commonwealth’s off-balance sheet instruments, primarily loan commitments and standby letters of credit, are expected to expire without being drawn upon; therefore, the commitment amounts do not necessarily represent future cash requirements. FASB ASC Topic 460, “Guarantees” clarified that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The carrying amount and fair value for standby letters of credit was $0.2 million at both September 30, 2016 and December 31, 2015. See Note 5, “Commitments and Contingent Liabilities,” for additional information.

Deposit liabilities: The estimated fair value of demand deposits, savings accounts and money market deposits is the amount payable on demand at the reporting date because of the customers’ ability to withdraw funds immediately. The carrying value of variable rate time deposit accounts and certificates of deposit approximate their fair values at the report date. Also, fair values of fixed rate time deposits for both periods are estimated by discounting the future cash flows using interest rates currently being offered and a schedule of aggregated expected maturities.

Short-term borrowings: The fair values of borrowings from the FHLB were estimated based on the estimated incremental borrowing rate for similar types of borrowings. The carrying amounts of other short-term borrowings such as federal funds purchased and securities sold under agreement to repurchase were used to approximate fair value due to the short-term nature of the borrowings.

Long-term debt and subordinated debt: The fair value of long-term debt and subordinated debt is estimated by discounting the future cash flows using First Commonwealth’s estimate of the current market rate for similar types of borrowing arrangements or an announced redemption price.

ITEM 1. Financial Statements and Supplementary Data
FIRST COMMONWEALTH FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents carrying amounts and fair values of First Commonwealth's financial instruments:

	September 30, 2016				
		Fair Value Measurements Using:			
	Carrying Amount	Total	Level 1	Level 2	Level 3
	(dollars in thousands)				
Financial assets					
Cash and due from banks	$76,456	$76,456	$76,456	$ —	$ —
Interest-bearing deposits	5,097	5,097	5,097	—	—
Securities available for sale	813,659	813,659	—	776,380	37,279
Securities held to maturity	389,513	396,994	—	396,994	—
Other investments	54,066	54,066	—	54,066	—
Loans held for sale	7,855	7,855	—	7,855	—
Loans	4,860,652	4,882,076	—	28,158	4,853,918
Financial liabilities					
Deposits	4,458,980	4,461,516	—	4,461,516	—
Short-term borrowings	1,330,327	1,329,740	—	1,329,740	—
Subordinated debt	72,167	63,858	—	—	63,858
Long-term debt	8,892	9,840	—	9,840	—

	December 31, 2015				
		Fair Value Measurements Using:			
	Carrying Amount	Total	Level 1	Level 2	Level 3
	(dollars in thousands)				
Financial assets					
Cash and due from banks	$66,644	$66,644	$66,644	$ —	$ —
Interest-bearing deposits	2,808	2,808	2,808	—	—
Securities available for sale	886,560	886,560	—	848,732	37,828
Other investments	62,952	62,952	—	62,952	—
Loans held for sale	5,763	5,763	—	5,763	—
Loans	4,683,750	4,690,852	—	30,979	4,659,873
Financial liabilities					