

Stock Yards Bancorp, Inc.
Form 10-K
March 13, 2018

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

Form 10-K

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

**For the Fiscal Year Ended Commission File Number
December 31, 2017 1-13661**

STOCK YARDS BANCORP, INC.

**1040 East Main Street
Louisville, Kentucky 40206
(502) 582-2571**

Incorporated in Kentucky I.R.S. No. 61-1137529

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

Title of each class: *Name of each exchange on which registered:*
Common Stock, no par value NASDAQ

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act).

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Yes **No**

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes **No**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **No**

Indicate by check mark whether the registrant has submitted electronically 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** **No**

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

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

Accelerated filer

Smaller reporting company

Emerging growth company

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

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

Yes **No**

The aggregate market value of registrant's voting stock (Common Stock, no par value) held by non-affiliates of the registrant as of June 30, 2017 (the last business day of the registrant's most recently completed second fiscal quarter) was \$802,453,551.

The number of shares of the registrant's Common Stock, no par value, outstanding as of February 23, 2018, was 22,715,321.

Documents Incorporated By Reference

Portions of Registrant's definitive proxy statement related to Registrant's Annual Meeting of Shareholders to be held on April 26, 2018 (the "Proxy Statement"), to be filed with the Securities and Exchange Commission, are incorporated by reference into Part III of this Form 10-K.

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Glossary of Acronyms and Terms

The following listing provides a comprehensive reference of common acronyms and terms used throughout the document:

ASU	Accounting Standards Update
Bancorp	Stock Yards Bancorp, Inc.
Bank	Stock Yards Bank & Trust Company
BOLI	Bank Owned Life Insurance
BP	Basis Point = 1/100 th of one percent
COSO	Committee of Sponsoring Organizations
CRA	Community Reinvestment Act of 1977
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
EPS	Earnings Per Share
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FHC	Financial Holding Company
FHLB	Federal Home Loan Bank
FHLMC	Federal Home Loan Mortgage Corporation
FNMA	Federal National Mortgage Association
GLB Act	Gramm-Leach-Bliley Act
GNMA	Government National Mortgage Association
WM&T	Wealth management and trust
KSOP	Combined employee profit sharing and stock ownership plan
LIBOR	London Interbank Offered Rate
MSA	Metropolitan Statistical Area
MSR	Mortgage Servicing Right
OAEM	Other Assets Especially Mentioned
Oldham	THE BANCORP, Inc.
OREO	Other Real Estate Owned
OTTI	Other-Than-Temporary Impairment
PSU	Performance Stock Unit
RSU	Restricted Stock Unit
SAR	Stock Appreciation Right
SEC	Securities and Exchange Commission
TDRs	Troubled Debt Restructurings
US GAAP	United States Generally Accepted Accounting Principles
VA	U.S. Department of Veterans Affairs

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Part I

Item 1. Business

Stock Yards Bancorp, Inc. (“Bancorp” or “Company”), headquartered in Louisville, Kentucky, is the holding company for Stock Yards Bank & Trust Company (“Bank”). Bancorp, which was incorporated in 1988 in Kentucky, is registered with, and subject to supervision, regulation and examination by, the Board of Governors of the Federal Reserve System. The Bank is wholly owned and is a state chartered bank. Because Bancorp has no significant operations of its own, its business and that of the Bank are essentially the same. The operations of the Bank are fully reflected in the consolidated financial statements of Bancorp. Accordingly, references to “Bancorp” in this document may encompass both the holding company and the Bank.

Stock Yards Bank & Trust Company

Stock Yards Bank & Trust Company is the banking and sole subsidiary of Bancorp and was chartered in 1904. The Bank is headquartered in Louisville, Kentucky and provides commercial and personal banking services in the Louisville, Kentucky, Indianapolis, Indiana and Cincinnati, Ohio metropolitan markets through 37 full service banking offices. The Bank is chartered under the laws of the Commonwealth of Kentucky. In addition to traditional commercial and personal banking activities, the Bank has a wealth management and trust department (WM&T) offering a wide range of investment management, trust, employee benefit plan, estate administration, and financial planning services. The Bank also originates and sells single-family residential mortgages. Additionally, the Bank offers securities brokerage services via its branch network through an arrangement with a third party broker-dealer. See Note 25 to Bancorp’s consolidated financial statements for information relating to the Bank’s business segments and “Item 2. Properties” for information regarding owned and leased properties.

At December 31, 2017, Stock Yards Bank & Trust Company had 580 full-time equivalent employees. Employees of Stock Yards Bank & Trust Company are entitled to participate in a variety of employee benefit programs including a combined employee profit sharing and stock ownership plan (“KSOP”). Management of Bancorp strives to be an employer of choice and considers the relationship with employees to be good.

Supervision and Regulation

Bank holding companies and commercial banks are extensively regulated under both federal and state laws. Changes in applicable laws or regulations may have a material effect on the business and prospects of Bancorp.

Bancorp, as a registered bank holding company, is subject to the supervision of and regulation by the Federal Reserve Board under the Bank Holding Company Act of 1956. In addition, Bancorp is subject to the provisions of Kentucky's banking laws regulating bank acquisitions and certain activities of controlling bank shareholders.

Kentucky and federal banking statutes delineate permissible activities for Kentucky state-chartered banks. Kentucky's statutes, however, contain a super parity provision for Kentucky chartered banks having one of the top two ratings in its most recent regulatory examination. This provision allows these state banks to engage in any banking activity in which a national bank, a state bank operating in any other state, or a federally chartered thrift could engage. The bank must first obtain a legal opinion specifying the statutory or regulatory provisions that permit the activity.

The Bank is subject to the supervision of the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation. The Federal Deposit Insurance Corporation ("FDIC") insures the deposits of the Bank to the current maximum of \$250,000 per depositor.

The Gramm-Leach-Bliley Act (the "GLB Act") allows for affiliations among banks, securities firms and insurance companies by means of a financial holding company ("FHC"). The GLB Act requires that, at the time of establishment of an FHC, all depository institutions within that corporate group must be "well managed" and "well capitalized" and must have received a rating of "satisfactory" or better under its most recent Community Reinvestment Act examination. Further, non-banking financial firms (for example an insurance company or securities firm) may establish an FHC and acquire a depository institution. While the distinction between banks and non-banking financial firms has been blurring over recent years, the GLB Act makes it less cumbersome for banks to offer services "financial in nature" but beyond traditional commercial banking activities. Likewise, non-banking financial firms may find it easier to offer services that had, heretofore, been provided primarily by depository institutions. In 2012, management of Bancorp chose to become an FHC.

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The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) was signed into law in 2010. Generally, the Dodd-Frank Act was effective the day after it was signed into law, but different effective dates apply to specific sections of the law. This extensive and complex legislation contained many provisions affecting the banking industry, including:

Creation of a Bureau of Consumer Financial Protection overseeing banks with assets totaling \$10 billion or greater while writing and maintaining several regulations that apply to all banks,
Determination of debit card interchange rates by the Federal Reserve Board,
New regulation over derivative instruments,
Phase outs of certain forms of trust preferred debt and hybrids previously included as bank capital, and
Increases to FDIC deposit coverage, revised calculations for assessing bank premiums, and numerous other provisions affecting financial institution regulation, oversight of certain non-banking organizations, investor protection, etc.

Bancorp continues to be subject to regulation under the Dodd-Frank Act; however, the current presidential administration has instructed federal agencies to reduce the regulatory burden on financial institutions.

The Community Reinvestment Act of 1977 (CRA) requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA, and banking regulators take into account CRA ratings when considering approval of certain applications. An unsatisfactory CRA rating could, among other things, result in the denial or delay of corporate applications filed by Bancorp or the Bank for proposed activities such as branch openings or relocations and applications to acquire, merge or consolidate with another banking institution or holding company.

The federal banking regulators have adopted rules limiting the ability of banks and other financial institutions to disclose non-public information about consumers to unaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to an unaffiliated third party. These regulations affect how consumer information is conveyed to outside vendors. The Bank is also subject to regulatory guidelines establishing standards for safeguarding customer information. These guidelines describe the federal banking agencies’ expectations for the creation, implementation and maintenance of an information security program, which would include administrative, technical and physical safeguards appropriate to the size and complexity of the institution and the nature and scope of its activities.

The Bank is subject to the Bank Secrecy Act and the USA Patriot Act. These statutes and related rules and regulations impose requirements and limitations on specified financial transactions and accounts and other relationships intended to guard against money laundering and terrorism financing. Financial institutions must take certain steps to assist government agencies in detecting and preventing money laundering and report certain types of suspicious

transactions. Regulatory authorities routinely examine financial institutions for compliance with these obligations, and failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

In 2013, the Federal Reserve Board and the FDIC approved rules that substantially amended the regulatory risk-based capital rules applicable to Bancorp and Bank. The rules implemented the regulatory capital reforms of the Basel Committee on Banking Supervision reflected in “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems” (“Basel III”) and changes required by the Dodd-Frank Act. The Basel III regulatory capital reforms became effective for Bancorp and Bank on January 1, 2015, and included new minimum risk-based capital and leverage ratios. The minimum capital level requirements applicable to bank holding companies and banks subject to the rules are:

- a common equity Tier 1 capital ratio of 4.5%,
- a Tier 1 risk-based capital ratio of 6% (increased from 4%),

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a total risk-based capital ratio of 8% (unchanged from previous rules), and a Tier 1 leverage ratio of 4% for all institutions.

The rules also established a “capital conservation buffer” of 2.5%, to be phased in over three years, above the regulatory minimum risk-based capital ratios, and will result in the following minimum ratios once the capital conservation buffer is fully phased in:

a common equity Tier 1 risk-based capital ratio of 7.0%,
a Tier 1 risk-based capital ratio of 8.5%, and
a total risk-based capital ratio of 10.5%.

The capital conservation buffer requirement began being phased in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Under these rules, Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

Common equity Tier 1 capital generally consists of common stock, additional paid-in capital and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions.

The rules allowed banks and their holding companies with less than \$250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Bancorp opted-out of this requirement.

As of December 31, 2017, Bancorp met the requirements to be considered well-capitalized and is not subject to limitations due to the capital conservation buffer.

Available Information

Bancorp files reports with the SEC including the Annual Report on Form 10-K, quarterly reports on Form 10-Q, current event reports on Form 8-K, and proxy statements, as well as any amendments to those reports. The public may read and copy any materials the Registrant files with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. Bancorp's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are also accessible at no cost on Bancorp's web site at <http://www.syb.com> after they are electronically filed with the SEC.

Item 1A. Risk Factors

Investment in Bancorp's common stock involves risk, and Bancorp's profitability and success may be affected by a number of factors including those discussed below.

Financial condition and profitability depend significantly on local and national economic conditions.

The Company's success depends on general economic conditions both locally and nationally. Most of Bancorp's customers are in the Louisville, Indianapolis, and Cincinnati metropolitan areas. Compared to regional or national financial institutions, Bancorp is less able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Some of Bancorp's customers are directly impacted by the local economy while others have more national or global business dealings. Deterioration in the quality of the credit portfolio could have a material adverse effect on financial condition, results of operations, and ultimately capital.

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Financial condition and profitability depend on real estate values in the Company's market area.

Bancorp offers a variety of secured loans, including commercial lines of credit, commercial term loans, real estate, construction, home equity, consumer and other loans. Bancorp's loans are secured by real estate (both residential and commercial) primarily in Bancorp's market areas. In instances where borrowers are unable to repay their loans and there has been deterioration in the value of the loan collateral, Bancorp could experience higher loan losses which could have a material adverse effect on financial condition, and results of operations.

If actual loan losses are greater than Bancorp's assumption for loan losses, earnings could decrease.

Bancorp's loan customers may not repay their loans according to the terms of these loans, the collateral securing the payment of these loans may be insufficient to ensure repayment and the wealth of guarantors providing guarantees to support these loans may be insufficient to aid in the repayment of these loans. Accordingly, Bancorp might experience significant credit losses which could have a material adverse effect on operating results. Bancorp makes various assumptions and judgments about the collectability of the loan portfolio, including the creditworthiness of borrowers and the value of collateral for repayment of many loans. In determining the adequacy of the allowance for loan losses, Bancorp considers, among other factors, an evaluation of economic conditions and Bancorp's loan loss experience. If Bancorp's assumptions prove to be incorrect or economic problems are worse than projected, the current allowance may not be sufficient to cover loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. Such additions to the allowance, if necessary, could have a material adverse impact on financial results.

Federal and state regulators annually review Bancorp's allowance for loan losses and may require an increase in the provision for loan losses or loan charge-offs. If regulatory agencies require any increase in the provision for loan losses or loan charge-offs for which Bancorp had not allocated, it would have a negative effect on financial results.

Fluctuations in interest rates could reduce profitability.

Bancorp's primary source of income is from the net interest spread, the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. Bancorp expects to periodically experience gaps in interest rate sensitivities of Bancorp's assets and liabilities, meaning that either interest-bearing liabilities will be more sensitive to changes in market interest rates than interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to Bancorp's position, this gap will work against Bancorp and earnings will be negatively affected.

Many factors affect fluctuation of market interest rates, including, but not limited to the following:

- inflation or deflation
- recession
- a rise in unemployment
- tightening money supply
- international disorder and instability in foreign financial markets
- the Federal Reserve's actions to control interest rates

The Federal Reserve increased the overnight federal funds rate three times in 2017 which led to the prime lending rate increasing from 3.75% to 4.50%. Bancorp benefits from rates increasing as the majority of variable rate loans are tied to prime with a lesser amount tied to LIBOR. While variable rate loans have re-priced at higher rates Bancorp has largely held deposit rates unchanged. Deposit rates generally do not reprice as quickly as loans which positively affects earnings as rates rise in the short term. Market expectations for 2018 include three additional 25 bps federal funds rate increases. Bancorp recognizes that eventually deposit rates will be adjusted upward which poses a risk to earnings. Migration of deposits out of Bancorp, as customers pursue higher rates, could impact liquidity and earnings as Bancorp competes for deposits. Changes in the mix of deposits could result in increased average rates paid on deposits, and lower earnings to Bancorp. Bancorp's asset-liability management strategy, which is designed to mitigate risk from changes in market interest rates, may not be able to prevent changes in interest rates from having a material adverse effect on Bancorp's results of operations and financial condition. Bancorp's most recent earnings simulation model estimated the impact of changing interest rates on earnings for the next 12 months indicates net interest income will decrease approximately 3% if interest rates immediately increase 200 basis points and decrease approximately 5% if rates decrease 200 basis points.

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Bancorp is subject to funding risk.

Funding risk represents the dependence Bancorp has on large commercial deposit relationships. Approximately 40% of Bancorp's total deposits are centralized in accounts with balances \$500,000 or greater. Bancorp considers these deposits core funds as they represent long-standing relationships and are a testament to Bancorp's commitment to partner with business clients by providing exemplary service and competitive products. A sudden shift in customer behavior within these deposits resulting in balances being reduced or moved out of the bank altogether could impact Bancorp's ability to capitalize on growth opportunities and meet current obligations. Bancorp has secondary sources of funding to draw upon as needed but the cost of those funds would be higher than typical deposit accounts which would negatively impact the financial condition and results of operation.

Significant stock market volatility could negatively affect Bancorp's financial results.

Income from wealth management and trust constitutes approximately 44% of non-interest income. Trust assets under management are expressed in terms of market value, and a significant portion of fee income is based upon those values. A large majority of wealth management and trust fees are based on market values which generally fluctuate with the overall capital markets.

Capital and credit markets experience volatility and disruption from time to time. These conditions place downward pressure on credit availability, credit worthiness and customers' inclinations to borrow. Prolonged volatility or a significant disruption could negatively impact customers' ability to seek new loans or to repay existing loans. The personal wealth of many borrowers and guarantors has historically added a source of financial strength to certain loans and would be negatively impacted by severe market declines. Sustained reliance on their personal assets to make loan payments would result in deterioration of their liquidity, and could result in loan defaults.

Competition with other financial institutions could adversely affect profitability.

Bancorp operates in a highly competitive industry that could become even more so as a result of earnings pressure of contending banks, legislative, regulatory and technological changes and continued consolidation. Bancorp faces vigorous competition in price and structure of financial products from banks and other financial institutions. In recent years, credit unions have expanded their lending mix and now compete heavily with banks in the commercial real estate market. Their high risk tolerance for fixed rate, long-term loans has adversely affected Bancorp's net loan growth and results of operations. Bancorp also competes with other non-traditional providers of financial services, such as brokerage firms and insurance companies. As internet-based financial services continue to grow in acceptance, Bancorp must remain relevant as a place where consumers and businesses value personal service while competitors offer these services without human interaction. The variety of sources of competition may reduce or limit margins on

banking services, reduce market share and adversely affect results of operations and financial condition. Bancorp's growth and expansion may adversely affect customer perceptions of the community based, customer oriented service Bancorp provides, thus damaging Bancorp's image in the market.

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An extended disruption of vital infrastructure could negatively impact Bancorp's business, results of operations, and financial condition.

Bancorp's operations depend upon, among other things, infrastructure, including equipment and facilities. Extended disruption of vital infrastructure by fire, power loss, natural disaster, telecommunications failure, information systems breaches, terrorist activity or the domestic and foreign response to such activity, or other events outside of Bancorp's control could have a material adverse impact on the financial services industry as a whole and on Bancorp's business, results of operations and financial condition. Bancorp's business continuity plan may not work as intended or may not prevent significant interruption of operations. Occurrence of any failures, interruptions, or security breaches of information systems could damage Bancorp's reputation, result in loss of customer business, subject the Company to additional regulatory scrutiny, or expose Bancorp to civil litigation and possible financial liability, any of which could have an adverse effect on Bancorp's financial condition and results of operation.

Security breaches or incidences of fraud could negatively impact Bancorp's business, results of operations, and financial condition.

Bancorp's assets which are at risk for cyber-attacks include financial assets and non-public information belonging to customers. Cyber security risks include cyber espionage, blackmail, ransom, theft, and corporate account takeovers. Bancorp employs many preventive and detective controls to protect its assets, and provides mandatory recurring information security training to all employees. Bancorp has invested in multiple preventative tools in an attempt to protect customers from cyber threats and corporate account takeover. Bancorp regularly provides educational information regarding cyber threats to customers. Bancorp utilizes multiple third-party vendors who have access to the Company's assets via electronic media. While Bancorp requires third parties, many of whom are small companies, to have similar or superior controls in place there is no guarantee that a breach of information could occur. Activities of the Bank that subject Bancorp to risk of fraud by customers, employees, vendors, or members of the general public include ACH transactions, wire transactions, ATM transactions, checking transactions, and loan originations. Repeated incidences of fraud or a single large occurrence would adversely impact Bancorp's reputation and results of operation.

Bancorp's credit metrics are at historically strong levels.

During 2017, Bancorp's solid asset quality metrics trended within a narrow range and exceeded solid benchmarks of the past several years to reach historically strong levels. Bancorp realizes that present asset quality metrics are exceptionally positive and, recognizing the cyclical nature of the lending business, the Company anticipates this trend will most likely normalize over time.

Bancorp’s accounting policies and methods are critical to how Bancorp reports its financial condition and results of operations. They require management to make estimates about matters that are uncertain.

Accounting policies and methods are fundamental to how Bancorp records and reports its financial condition and results of operations. Bancorp must exercise judgment in selecting and applying these accounting policies and methods so they comply with United States generally accepted accounting principles (“US GAAP”).

Bancorp has identified certain accounting policies as being critical because they require management’s judgment to ascertain the valuations of assets, liabilities, commitments and contingencies. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset, or reducing a liability. Bancorp has established detailed policies and control procedures intended to ensure these critical accounting estimates and judgments are well controlled and applied consistently.

The policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding Bancorp’s judgments and the estimates pertaining to these matters, there can be no assurances that actual results will not differ from those estimates. See the “Critical Accounting Policies” in the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for more information.

Bancorp operates in a highly regulated environment and may be adversely affected by changes to or lack of compliance with federal, state and local laws and regulations.

Bancorp is subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal or state legislation could have a substantial impact on Bancorp and its operations. Additional legislation and regulations may be enacted or adopted in the future that could significantly affect Bancorp’s powers, authority and operations, which could have a material adverse effect on Bancorp’s financial condition and results of operations. If Bancorp’s policies, procedures and systems are deemed deficient, the Company would be subject to liability, including fines and regulatory actions, which may include restrictions on the ability to pay dividends and the requirement to obtain regulatory approvals to proceed with certain aspects of Bancorp’s business plan, including branching and acquisition plans.

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Bancorp's ability to stay current on technological changes in order to compete and meet customer demands is constantly being challenged.

The financial services industry is constantly undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. Future success of Bancorp will depend, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional operational efficiencies and greater privacy and security protection for customers and their personal information. Many of Bancorp's competitors have substantially greater resources to invest in technological improvements. Bancorp may not be able to effectively implement new technology-driven products and services as quickly as competitors or be successful in marketing these products and services to its customers. Bancorp relies on third party providers for many of its technology-driven banking products and services. Some of these companies may be slow to respond with upgrades or enhancements to their products to keep pace with improvements in technology or the introduction of competing products. Failure to successfully keep pace with technological change affecting the financial services industry could impair Bancorp's ability to effectively compete to retain or acquire new business and could have an adverse impact on its business, financial position, results of operations and liquidity.

Bancorp is dependent upon outside third parties for the processing and handling of the Company's records and data.

Bancorp relies on software developed by third-party vendors to process various transactions. In some cases, Bancorp has contracted with third parties to run their proprietary software on the Company's behalf. While Bancorp performs a review of controls instituted by the applicable vendors over these programs in accordance with industry standards and performs testing of user controls, the Company relies on the continued maintenance of controls by these third-party vendors, including safeguards over the security of client data. Bancorp may incur a temporary disruption in the Company's ability to conduct business or process transactions, or incur reputational, if the third-party vendor fails to adequately maintain internal controls or institute necessary changes to systems. Such a disruption or breach of security could have a material adverse effect on Bancorp's business. Further, if these third-party service providers experience difficulties, or should terminate their services, and the Company is unable to replace them on a timely basis, Bancorp's business operations could be interrupted. If an interruption were to continue for a significant period of time, the Company's business, financial condition and results of operations could be adversely affected.

Bancorp may not be able to attract and retain skilled people.

Bancorp's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in the industry and the markets in which Bancorp engages can be intense, and the Company may not be able to retain or hire the people wanted or needed. To attract and retain qualified employees, Bancorp must compensate them at market levels. If Bancorp is unable to continue to attract and retain qualified employees, or do so at rates necessary to

maintain the Company's competitive position, Bancorp's performance, including the Company's competitive position, could suffer, and, in turn, adversely affect Bancorp's business, financial condition or results of operations.

Bancorp invests in partnerships that generate federal income tax savings and these may not continue.

Bancorp invests in certain partnerships that yield federal income tax credits resulting in higher net income for Bancorp. These transactions may also include lending to the developer, further enhancing the profitability of the transaction. These transactions typically involve a very limited number of counterparties. The availability and suitability of these transactions are not particularly predictable and may not continue to be favorable to Bancorp. The recently enacted income tax reform could result in fewer transactions and the extent to which federal income tax credits favorably effect Bancorp's net income. Therefore the positive effect on Bancorp's net income may not continue.

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Changes in customer use of banks could adversely affect Bancorp’s financial condition and results of operation.

The rapid evolution of non-bank alternatives for initiation and completion of financial transactions puts Bancorp at risk of losing sources of revenue and funding. The ability of customers to pay bills, transfer funds, and purchase assets without utilizing the banking system could result in loss of fee income, deposits, and loans. If Bancorp is unable to continue timely development of competitive new products and services, its business, financial condition and results of operations could be adversely affected.

The Current Expected Credit Loss (CECL) accounting standard will result in a significant change in how Bancorp recognizes credit losses and may have a material impact on the Company’s financial condition or results of operations.

In June 2016, the Financial Accounting Standards Board issued an accounting standard update, “Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments,” which replaces the current “incurred loss” model for recognizing credit losses with an “expected loss” model. Whereas the incurred loss model delays recognition of loss on financial instruments until it is probable a loss has occurred, t